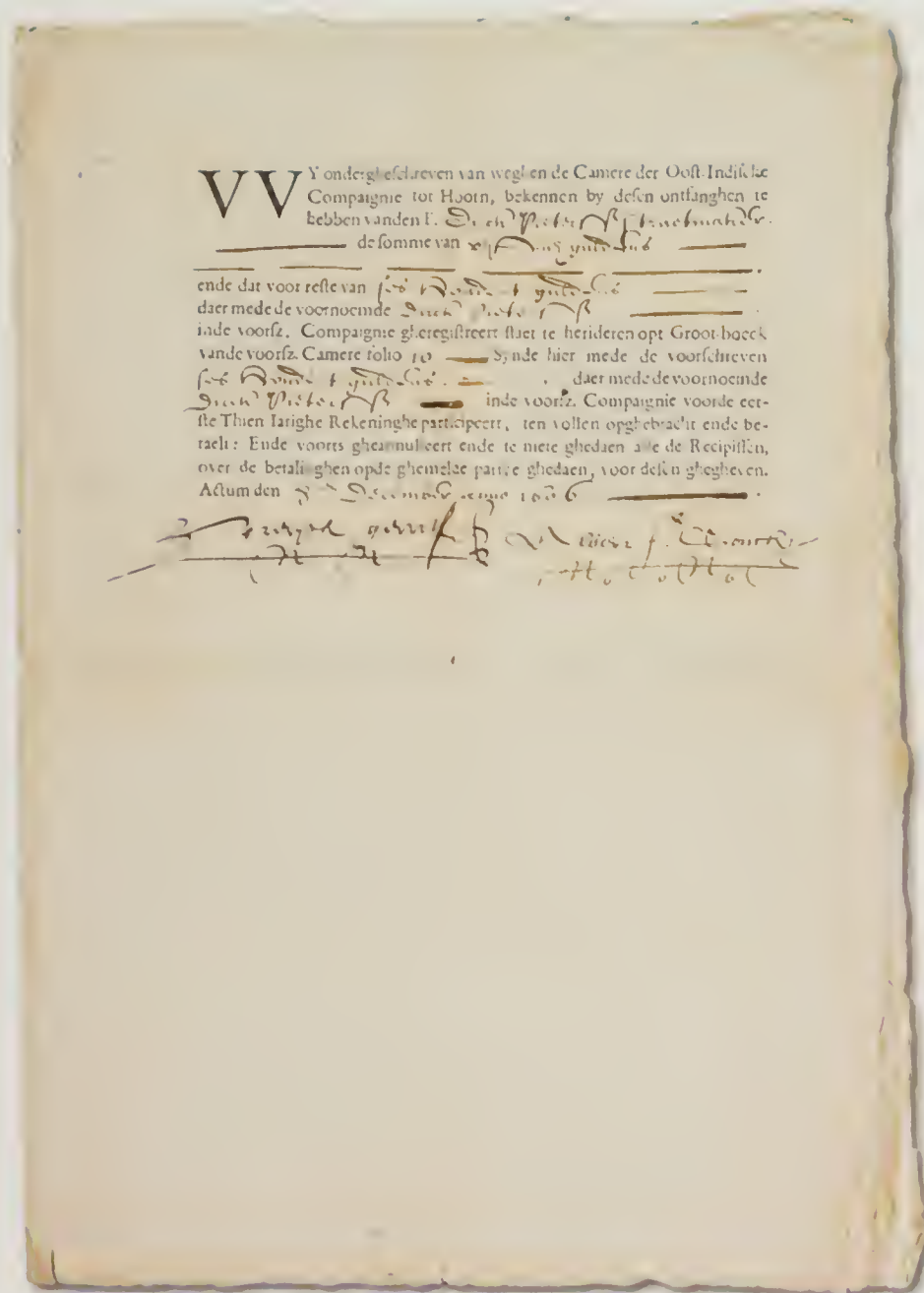


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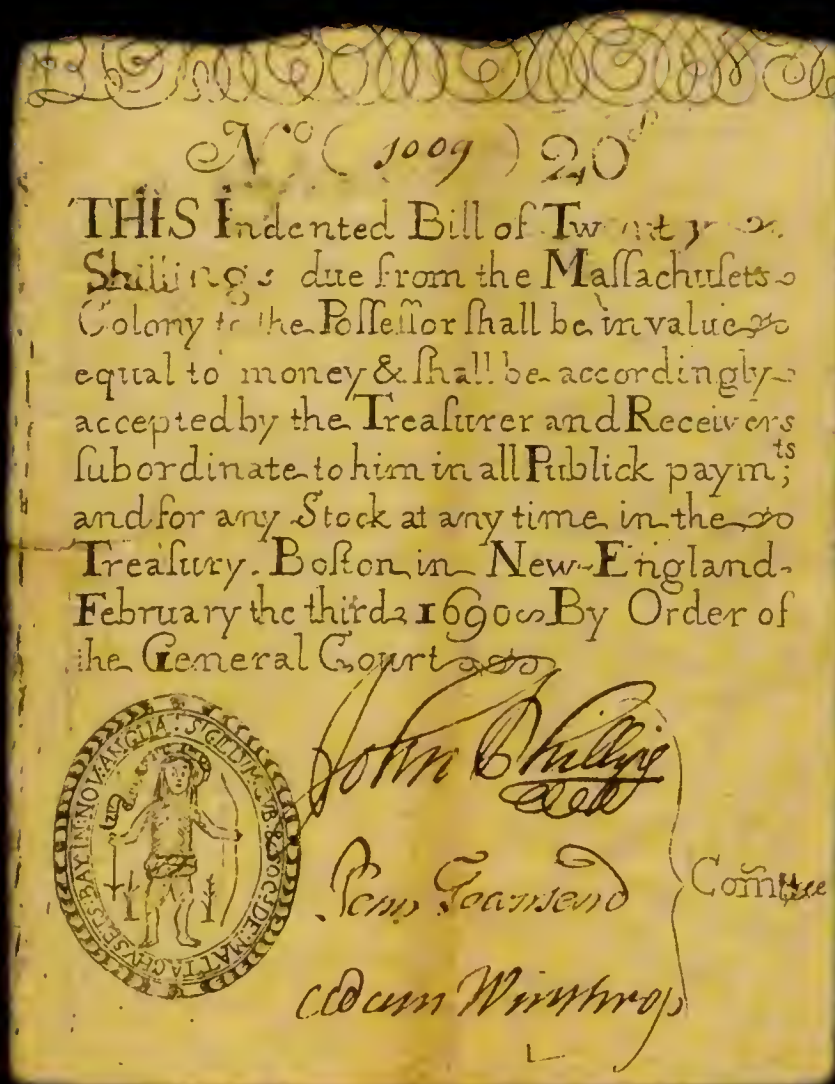
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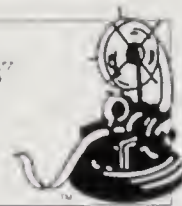
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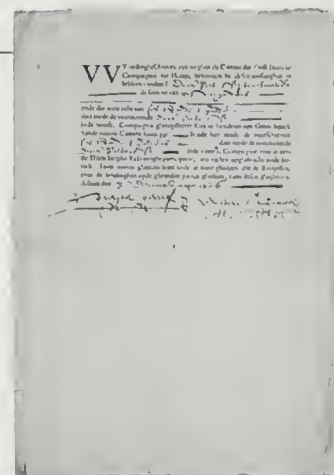
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Message to Members

By David Cowen, President and CEO

TO THE MUSEUM'S members, friends, patrons, board and staff: Thank you for entrusting me with the presidency of this wonderful asset. I am honored and excited to take the helm of the Museum that represents our nation's collective financial memory. In just a few short weeks I have seen so many positives: we opened a new exhibit featuring early Dutch finance and the founding of America. This exhibit is co-curated and sponsored by NYSE-Euronext and features a Dutch share certificate, the world's oldest dating to 1606. It is the same document featured in the movie "Oceans 12." Dr. Henry Kaufman, sponsor of our Kaufman Lecture Series, delivered a speech to a packed crowd on the current economic crisis on September 22, and our first school groups of the fall have started their tours. The look of interest in their faces is testimony that we are making an impact in the area of financial education.

These accomplishments do not mean we can rest on our laurels. While there is much that has been done, there is much more that needs to be done. We need to be on the forefront of financial education. We need to continue to be active in explaining the current economic crisis. And we need to secure our own financing to run these wonderful programs in what has become an exceedingly difficult gift giving environment.

All these goals can be accomplished. I am ready for the challenge and will use my background, which combines



Financial historian and hedge fund manager David Cowen was named the Museum's new president in September.

the study of financial history, practical Wall Street experience and an inherent passion for museums, to reach these objectives. But I am not alone: I have

inherited a first-rate staff and an energized board to ensure success. I look forward to working with all of you as we build on this wonderful base. **FH**

Founder's Letter

By John E. Herzog

THIS SEPTEMBER THE MUSEUM enthusiastically welcomed a new president, David Cowen, who brings to the organization a unique combination of scholarship and business acumen. David has over 20 years experience as a trader on Wall Street, including in the foreign exchange groups at Bankers Trust and Deutsche Bank. The founder of Quasar Capital Partners, a macro hedge fund, he holds a BA in American history from Columbia College, an MBA from the Wharton School of Business, as well as an MA and Ph.D. in American history from NYU. He has written extensively on U.S. financial history, and is co-author of *Financial Founding Fathers: The Men Who Made America Rich*.

The first board meeting in David's administration was held on September 17 in the Museum's conference

room on the Councourse Level, and the ranks were swelled by our three new trustees: Charlotte Beyer of the Institute for Private Investors, Mark Shenkman of Shenkman Asset Management and Ken Winans, of Winans International, our first trustee from California.

The meeting went smoothly, with the staff attending. The managers reported on the progress and other issues in their departments, and there were good questions from the trustees. David's style is one of genuine openness and a clear, straightforward presentation, and that was welcomed by all. The door to his office is always open, too, and he has time for all the questions that have arisen in this transition period. His first two weeks have been quite busy, and there have been all of the normal adjustments to this change and new management style, which is completely transparent and very satisfying.

Following the board meeting, the trustees enjoyed a brief tour of the Museum's new exhibit, "Actien Han-

del: Early Dutch Finance and the Founding of America," and then were treated to a special viewing of the Magna Carta exhibition at Fraunces Tavern. At a dinner celebrating David's beginning days there was wonderful enthusiasm, with the board and staff reviewing the Museum's objectives and prioritizing the work ahead. There will be a lot of work, and it won't all be easy, but as my mother used to say, "There are no roses without thorns."

We have an impressive list of co-chairs for the annual gala on January 11, 2010, and our honoree will be Bill Donaldson. Important new relationships are developing more rapidly than anyone had anticipated, and we are all impressed with the range of the opportunities before us. I hope you will become a part of these activities, whether as a volunteer, docent, member, visitor or gala guest, and we look forward to hearing from you. Please join us in welcoming David to the Museum, and wishing him great success ahead. **EH**

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The Museum is most grateful for the support of the following corporations who have generously provided funding for the Museum in the past year.

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For information about participating in the Museum's corporate membership program please contact Jeanne Baker Driscoll, Director of Development, at 212 908-4694 or jdriscoll@moaf.org.

Museum displays “Actiën Handel: Early Dutch Finance and the Founding of America”

By Leena Akhtar, Exhibits and Archives Director

IN SEPTEMBER, museums and cultural organizations around New York City celebrated the 400th anniversary of the discovery of Manhattan by Henry Hudson and the crew of the *Half Moon*. In the early 1600s, Amsterdam was a thriving financial center, and the home of the first exchange-traded company—the Dutch East India Company, under whose mandate Hudson explored the waters around New York City. The Museum of American Finance was pleased to partner with the New York Stock Exchange, the Amsterdam Stock Exchange, the Amsterdam City Archives and Stichting VvdE to present a rare and important collection of artifacts about the role of early Dutch finance in the colonization and founding of the United States.

The exhibit was divided into four parts, covering the Dutch East India Company (also known as the VOC), the Dutch West India Company and the founding of the New Amsterdam colony, the South Seas and Mississippi Bubbles, and John Adams' efforts in Amsterdam to obtain a loan from the Dutch.

On display was the first-ever share certificate, a receipt for Dutch East India Company shares dating from 1606. Next to it was the first government regulation of share trading, an edict banning naked short-selling dating from 1610. Also in the first case were a perpetual bond from 1624 which is still paying, and the first formal shareholder complaint against the management of a publicly-traded company, dated 1622.

The New Amsterdam colony was established by a directive from the West India Company (the WIC) in 1624, mandated to profit from the



The Amsterdam Stock Exchange, interior view.

lucrative fur trade with local Native Americans. Its most famous governor was Peter Stuyvesant, who served in Curacao before being appointed Governor of New Amsterdam. On display were the will he had notarized before he joined the WIC, as well as another government ban on naked short selling, this time in WIC stocks.

The year 1720 saw the implosion of two major speculative bubbles in Europe, as well as a smaller one in the Netherlands. The Mississippi and South Seas Companies were formed in France and England respectively, to profit from the vast natural resources in the new world. The profit potential of these unexploited resources loomed large in the popular imagination (fueled by the claims of company directors), and demand for the stocks skyrocketed until eventually they reached completely unrealistic heights. To make matters worse, both the governments of France and England were persuaded to exchange their debt

for stock in the company, so holders of government debt became shareholders. When the bubbles finally burst, the unwinding in the market caused chaos in England and France. The speculative fervor eventually reached Amsterdam, but to a lesser degree. Even so, the collapse was followed by a slew of satirical material lampooning the speculators and *Wind-Handel* (Wind-Trade) was produced as a reminder about the follies of speculating.

The final display contained a book of 18th century notary documents from the Amsterdam City Archives, which includes agreements between John Adams and the Amsterdam merchants for a 5 million-guilder loan to the Continental Congress. Adams was in Amsterdam juggling the parallel processes of securing recognition of the new republic and negotiating the loan needed to pay for the war. He called his success in Amsterdam “the greatest triumph of my life.” **FH**

Letter to the Editor

I enjoyed the story in the most recent issue of *Financial History* magazine about Hetty Green. She was one of the founders of the Hathaway side of Berkshire Hathaway. I'm enclosing a copy of the pages of the initial December 14, 1888 meeting in which the founding shareholders are listed. You will notice on the next-to-last page that Hetty Green is shown as signing up for \$25,000 of the original \$400,000 capitalization.

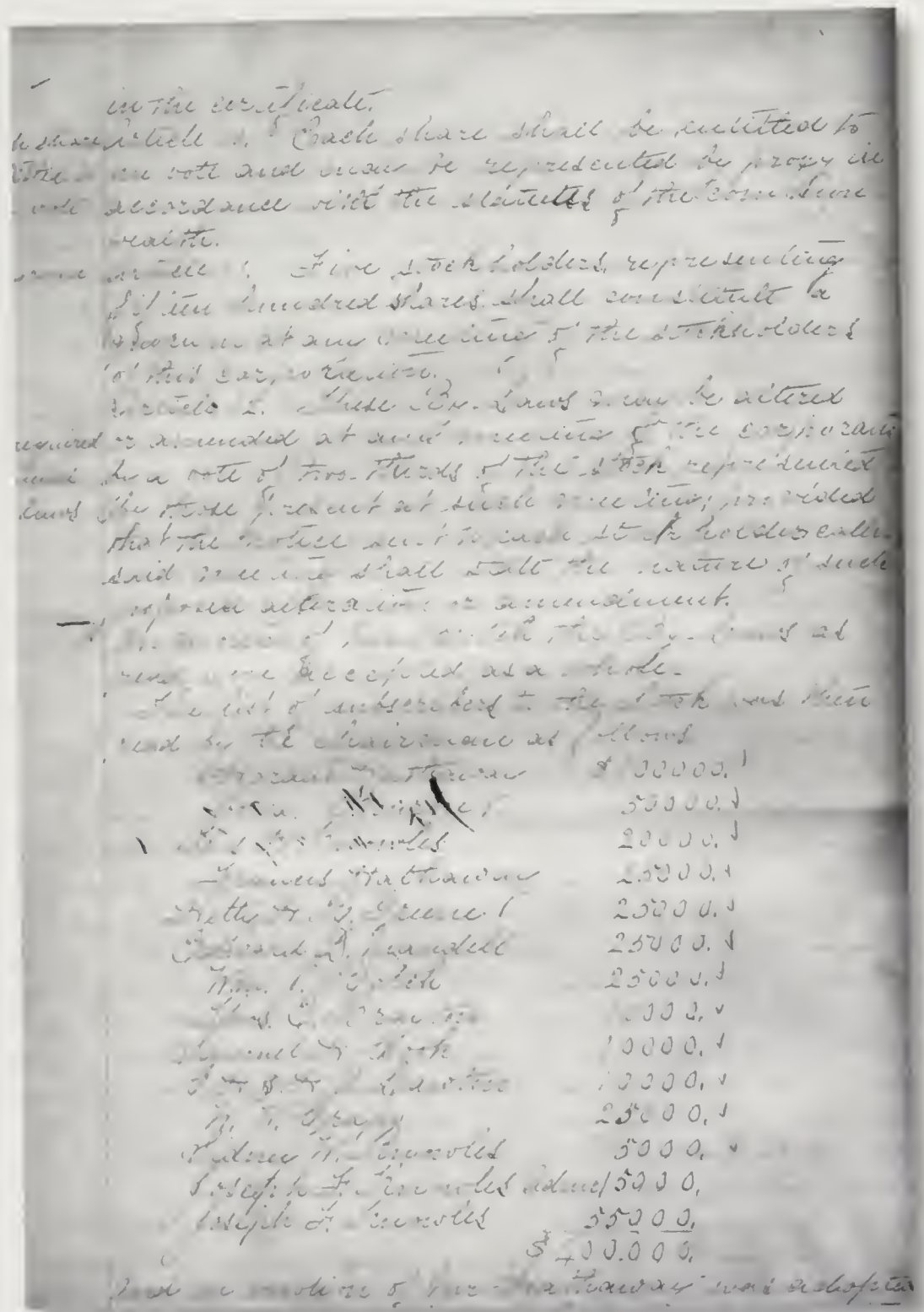
Considering her behavior, listing Hetty as an ancestor of sorts qualifies more as a confession than a boast. Of one thing I'm sure: She would disapprove of our lavish headquarters, consisting of one floor and 20 employees.

I continue to enjoy your magazine, and my trip to the Museum with Carol Loomis was a real highlight. I hope I can get back before long.

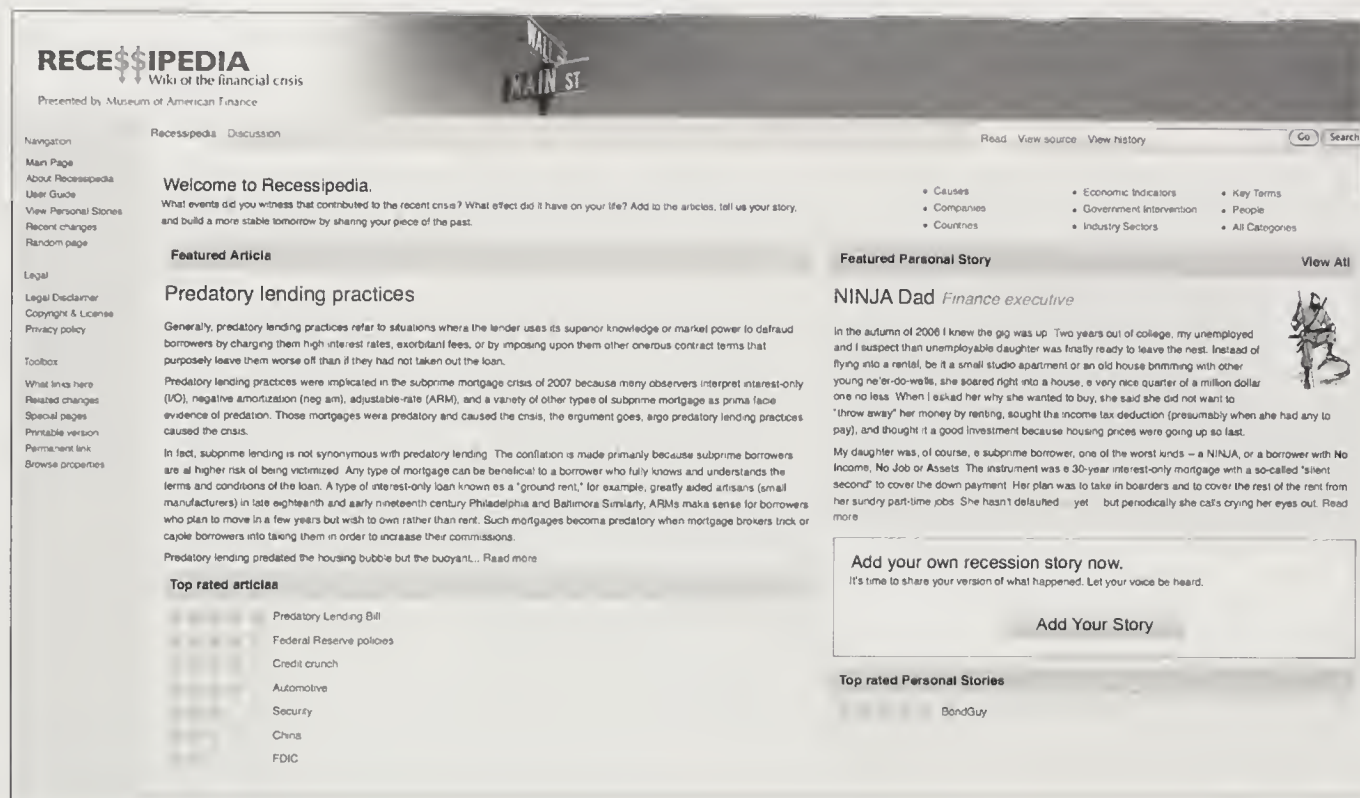
Sincerely,

Warren E. Buffett
Chairman, Berkshire Hathaway Inc.

A reproduction of one of the pages from the initial Hathaway meeting on December 14, 1888 showing that Hetty Green was a founding shareholder of the company. Green is one of 10 groundbreaking women in finance featured in the Museum's "Women of Wall Street" exhibit, on display through January 2010.



A Year After Financial Crisis, Museum Launches “Recessipedia” to Avoid a Repeat



THE MUSEUM RECENTLY launched Recessipedia (www.recessipedia.org), a wiki designed to tap the wisdom of crowds from Wall Street to Main Street to learn the causes of the financial crisis. Modeled on Wikipedia, Recessipedia's articles can be created, written and edited by anyone. But unlike Wikipedia, the Museum's wiki has a distinct goal of investigating past events. The wiki also collects first-person accounts, and welcomes people and organizations to contribute their own points of view about what happened leading up to and during the crisis.

"People still argue over what caused the Great Depression," said Museum president David Cowen. "But what if we had recorded the personal accounts of every person who had a role in the financial system? We might have been able to distill the Depression's precise causes and the moment-by-moment way it unfolded, drawing lessons from

which future crises could be avoided. Our hope is that Recessipedia can perform that function in the decades to come."

Recessipedia is built in the academic tradition of cataloguing first-person accounts of historical events, similar to oral history projects, recognizing that the biases and errors inherent in such efforts can be of significant value to future generations. Its opening to the public in beta form follows a three-month "alpha" stage where the wiki's technology was assembled and tested and seed content was written.

Makovsky + Company, one of the nation's leading independent public relations and investor relations firms, conceived of Recessipedia and developed it along with the Museum as a way to use social media to advance the Museum's mission of educating and engaging the public in financial history.

Recessipedia has two components: articles and personal stories. The articles section is built on the Wikimedia foundation's open source code, enabling anyone who has read or contributed to Wikipedia to be instantly familiar with its format and features. While the wiki's content in this area will evolve over time, each entry will relate to the recession with the goal of understanding its roots, building a chronology of events, exploring the effects of these events on people, markets, society and industry, and covering the efforts made to recover from the crisis.

"One of the challenges of studying history is getting to the bottom of what happened during key moments such as this," said Leena Akhtar, the Museum's Exhibits and Archives Director. "Even when you have video recording, transcripts and hundreds of witnesses to an event, multiple points of view and sharp differences of opin-



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ion will appear. We expect it to be no different on Recessipedia."

The personal stories section takes a unique approach to recording first-person accounts of history. Once a contributor signs in, creating a username that will be associated with the entry but not requiring proof of identity, a series of questions are presented. These include a numerical grade on how severely the person was affected by the recession, identifying what part of life was most affected by the recession (home value, employment, stress, etc.) and asking what lessons were learned from dealing with the recession. Finally, the individual is asked to contribute his or her story about the past few years. This combination of standardized and free-form information capture is a new historical research methodology, and will help researchers in the future analyze the mass of data Recessipedia is expected to generate.

An Editors Board, consisting of volunteers who have worked with the Museum over the past few years, has been assembled to address grievances, enforce the wiki's rules of conduct and train additional volunteers to handle the growing body of work. Over the past few months, these volunteers have worked to generate hundreds of articles and "stub" pieces that the public is now invited to add on to.

"As awful as the recession has been, we're fortunate that it's come at a time when the technology exists that can help us avoid its repetition," said David Rosen, group vice president, Makovsky + Company. "The more information we have, the better the lessons we'll be able to learn. People should consider their entry into Recessipedia as a down payment on a more secure financial future." **FH**

Wall Street and the Dust Bowl

By Dan Cooper and Brian Grinder

Nothing that you see or hear or read will be likely to exaggerate the physical discomfort or material losses due to these [dust] storms. Less emphasis is given to the mental effect, the confusion of mind resulting from the overthrow of all plans for improvement or normal farm work, and the difficulty of making other plans, even in a tentative way. To give just one specific example: the paint has been literally scoured from our buildings by the storms of this and previous years; we should by all means try to "save the surface;" but who knows when we might safely undertake such a project? The pleasantest morning may be a prelude to an afternoon when the "dust devils" all unite in one hideous onslaught. The combination of fresh paint with a real dust storm is not pleasant to contemplate.

—Caroline Henderson
March 8, 1936

THERE ARE NO INTERSTATE highways in the heart of the Dust Bowl, and the closest television station is in Amarillo, Texas.¹ No place in the United States could be more different from the hustle and bustle of Wall Street than this sparsely populated, flat, treeless plain. Yet in the 1930s, it became symbolic of the ailing American economy as severe drought and unbelievable dust storms turned the Dust Bowl area into a virtual wasteland.

At the beginning of the Great Depression, the Dust Bowl was unaffected by the stock market crash and the economic hardships that were plaguing the rest of America. As author Timothy Egan has noted, "On the High Plains, the Wall Street gyrations were a distant noise." *Nation's Business's* "Map of the Nation's Business"

for January 1, 1930 showed the High Plains, in the heart of the nation, experiencing "good" business conditions while most of the rest of the nation's economy was described merely as "fair." The 1931 wheat crop was a record breaker, but the combination of lower demand because of the depression along with the increase in supply sent the price plummeting dramatically to a mere 25 cents a bushel; at the same time, the cost of producing a bushel of wheat, according to historian Pamela Riney-Kehrberg, was about 56 cents. Many farmers didn't even try to sell their wheat that year and piled much of the excess on the ground. To make matters worse, the drought had begun.

Droughts are not uncommon on the High Plains where they occur with some regularity about every 20 years. But there were other factors in the 1930s that, when combined with drought conditions, produced massive wind erosion that blew away millions of tons of topsoil and left untold acres of land permanently scarred.² Drought conditions dominated the rest of the decade and forced about a quarter of the population to flee the area. Those who chose to stay were often forced to appeal to the federal government for relief. By the middle of the decade, dust storms had become a part of everyday life. For instance, during the first four months of 1935 in Dodge City, Kansas, there were only 13 days that were free of dust.

The experience of a dust storm is hard to describe, but Dust Bowl survivor Caroline Henderson's depiction of the aftermath of such storms gives a fairly good idea of what people had to put up with: "Dust to eat, and dust to breathe and dust to drink. Dust in the beds and in the flour bin, on dishes

and walls and windows, in hair and eyes and ears and teeth and throats, to say nothing of heaped up accumulations on floors and window sills after one of the bad days."

On the "bad days," residents could watch the dust clouds rolling towards them from several miles away, and when the storm hit it engulfed everything in dust, darkness and confusion. Some who got caught out in a dust storm were later found dead from suffocation. Others suffered from "dust pneumonia" which killed its victims more slowly. The storms, which could last for days, were often accompanied by static electricity that could literally cook wheat on the stalk. During the storms, people avoided touching each other since the static electricity generated by such an act could knock a person to the ground.³ Riney-Kehrberg relates a story about a dust storm in Kansas that was followed by rain. The dust storm blew one farmer's chickens into the neighbor's field, and then rain mixed with dust created a paste that glued the chickens to the ground. The amused farmer and his wife went out and rescued most of the chickens, but the next morning they noticed "little puffs of feathers that ...marked the location of chickens that they, but not the coyotes, had missed."

One of the worst dust storms of the decade occurred on Palm Sunday, April 14, 1935. The day started out sunny and clear, but a dust storm that began in North Dakota headed south through the Great Plains. By the time it reached Kansas, it was 200 miles wide accompanied by 65 mile an hour winds. When it hit an area, the temperature dropped dramatically and total darkness ensued. Many who experienced this black blizzard thought the world was ending. Folk

singer Woody Guthrie, who weathered the storm in Pampa, Texas wrote the song "So Long, It's Been Good to Know Yuh" as the storm raged.⁴

On the East Coast there was a general attitude of indifference or disbelief about the dust storms that were plaguing the plains. H.L. Menken's exaggerated views of high plains farmers as "congenital and incurable unfortunates" who should be sterilized "on a wholesale scale" reflects to a certain extent how most Americans viewed Dust Bowl farmers. Those who doubted the existence of dust storms got to experience one for themselves in 1934 when a storm that began in Montana and Wyoming dumped dust on Chicago and then New York City. According to a front page *New York Times* story, the storm darkened the skies for five hours and dumped an estimated 40 tons of dust per cubic mile on the city before it moved out into the Atlantic Ocean. New Yorkers didn't get to experience the static electricity generated by the more severe storms on the plains and no paint was scoured off buildings by hard blowing dust, but life in the city was certainly uncomfortable for a short period of time.

Wall Street was somewhat lethargic on the day of the storm with the Dow dropping less than a point. Although the dust in the air contributed to the general gloominess, Wall Street was far more worried about regulatory changes coming from Washington and the overall disdain that the general public felt for brokers. Two items in the *New York Times* "Topics in Wall Street" column on the day following the dust storm reflected this. The first, entitled *Wall Street Psychology*, observed, "Sharp and surprising stock market rallies sometimes take root in an atmosphere of gloom and despair. The gloom hung heavy over Wall Street yesterday, and for this reason alone some market authorities

were disposed to look for a rally soon. Among the factors entering into brokerage pessimism were the decline in Stock Exchange seats, the prospect of swift action by the Senate on the Stock Exchange Control Bill, the weakness in the stock market and the absences of public interest in trading." The other item bemoaned, "Even if the Wall Street broker had not been the target of enough slings and arrows from the legislative halls and other sources, he might have cause to be somewhat saddened by the printed implication of a supposedly sympathetic commentator that he is no better than a tipster. Unfortunately, the recent heavy attacks have made the skin of Wall Street thinner rather than thicker, and the Street has cast about hopefully and sometimes almost indiscriminately for friends." Even as Great Plains dust fell on their faces, Wall Street brokers had more important things to worry about.



Loose soil, blown by Dust Bowl winds, piled up in large drifts on a farm in Kansas, 1936.

Although the worlds of the depression era Great Plains farmer and the Wall Street broker were very different, there were a number of similarities between the two occupations. Both jobs involved managing risk, and when risk was not managed well in either instance it resulted in catastrophic consequences.⁵ In both fields, diversification played a very impor-

tant role. Farmers who gambled the entire farm on a single crop such as wheat in a semi-arid region bore a great deal of risk that could have been easily reduced through diversification into other crops. Finally, both farmers and brokers found themselves increasingly dependent on new technologies in order to operate successfully.

The drought and the dust storms finally ended, but not because of state and federal efforts to curb wind erosion or because farmers finally wised up and started treating the land with respect (although many farmers began adopting conservation methods to prevent wind erosion). It ended simply because the rains returned. The return of moisture to the region along with increasing demand for wheat at the beginning of World War II brought prosperity back to the Dust Bowl.

Historians and environmentalists continue to argue over the lessons to be learned from the Dust Bowl. Some see it as an indictment of capitalism, others hold that it was just part of a naturally recurring cycle, and many warn that we will face more disastrous dust blizzards in the future.

The ominous approach of a dust blizzard was captured by many photographs during the 1930s and will be forever fused in the American psyche as a symbol of economic and environmental stress. Our most recent "financial dust bowl" rekindled some of those old fears from the Great Depression, and while it appears that we are in the beginning stages of recovery, we can only hope that the dust-dampening rains are here to stay. **EH**

Dr. Dan Cooper is the president of Active Learning Technologies. Brian Grinder is a professor at Eastern Washington University and a member of Financial History's editorial board.

continued on page 27

COLLATERAL DAMAGED

OUR NATIONAL DEBT:
\$5,599,264,635.550.
YOUR *Family Share* \$72,836.
THE NATIONAL DEBT CLOCK

NATIONAL DEBT INCREASE PER SECOND \$ 10,000
INTEREST COST - \$292 BILLION

The Marketing of Consumer Debt to America

By Charles R. Geisst

WHEN THE NATIONAL DEBT clock was first introduced in 1989, New Yorkers became familiar with its constantly increasing digits as a sober reminder of government borrowing. Ten years

later in the 1990s, the clock was stopped as the debt fell dramatically during the Clinton administration, a cause for mild celebration. But the debt revolution had not ended; it was only taking a breather. It reappeared in 2002 as debt began increasing again

during the Bush administration. Six years later, the inevitable happened. Perched high on a building at the corner of 43rd Street and Sixth Avenue, the national debt clock stopped its inexorable counting for repairs. The old clock did not have enough digits;

so it had to be replaced, on October 9, 2008, to account for the increasing amount of the national debt. As the Treasury and the Federal Reserve scrambled to provide assistance to banks, insurance companies and other institutions during the financial crisis, the Durst family, who maintain the clock, decided to keep the tradition alive as conditions worsened. Americans did not need a reminder of the burgeoning debt burden facing the government, however. They too were facing a personal debt crisis of equally historic proportions.

The numbers on the debt clock tell only a part of the story of American indebtedness. The amount of private debt owed by consumers also is a considerable figure that is equally difficult to pay down. The approximately \$2.5 trillion in consumer debt currently outstanding (mortgages excluded) represents \$8,000 per person in addition to the \$10 trillion displayed on the debt clock, for \$40,000 per person. Mortgages outstanding add another \$15 trillion to the bill, for \$88,000 per person.

The problem is that consumer debt incurs higher interest rates than mortgage debt does and costs considerably more than the government pays on its debt. Even a crude estimate of how much interest is paid in the United States per year is a sobering number. If the consumer debt is charged at 10% per year, mortgages at 6%, and government debt at 4%, the total annual interest bill is \$1.55 trillion, and this does not include corporate or municipal debt payments. An individual's personal share of this debt service is about \$5,200, and this figure represents just the average interest charges that must be paid either as interest itself or in the form of income tax. Those payments must be made before one can consider principal repayments, and they do not include the increased government borrowing necessary for the bailout after the financial crisis began.

As the numbers grow, the question constantly asked is how large will they become in the future? That may be the wrong way of looking at the problem. The more important questions are how it got to this point and what must be done to ensure that it abates in the future. An immediate solution is not at hand. High debt levels cause impoverishment; they will in the future as they have done in the past. Interest charges have been viewed with suspicion for 3,000 years of Western history, but within the last 30 years they lost their fearsome nature as large numbers of people felt so sanguine about their ability to pay that the odious nature of debt was forgotten. This will prove to be the most egregious error of modern culture.

In the 70 years between the Depression and the current financial crisis, most optimists thought that significant progress had been made in fighting high interest rates, loan sharking, and excessive debt. But that was not the case. Although lenders no longer charged 1,000% interest, rates exceeding 20–30% were not uncommon. The great irony was that state laws had been passed liberalizing interest rates that consumers could be charged. The old usury laws were weakened in an attempt to deal a blow to illegal lenders who charged exorbitant rates, destroying borrowers' ability ever to pay their way out of debt. The door was opened for consumer credit companies to fill the void with interest rates lower than those of loan sharks. Often, their rates were not lower and the consequences were similar.

Lending money is one of the oldest professions and not always the most admired. No other business practice has been as thoroughly criticized for more than 2,000 years. Presidents, finance ministers, popes, kings and saints have labeled interest as a process that drains the life out of the economy, impeding progress at every turn. Historically, lenders have all

shared a common trait in the eyes of their critics. Their purpose was to "beggar-thy-neighbor" by charging high rates of interest on loans.

For centuries, antilending feelings were so strong that Dante placed moneylenders in the inferno along with the inhabitants of Sodom. Scores of writers from the early church fathers to Shakespeare and Adam Smith spoke out against them, calling for an end to their evil ways. Smith actually favored regulating the hateful practice, and the Bard wrote famously about the pound of flesh as recompense for Shylock's services.

In a remarkable turnaround, today's lenders are not considered to be exploiting their neighbors but providing them with loans at a so-called market rate. The only true crooks today are those who covertly charge extortionate rates and use strong-arm tactics to make the borrower pay. When debt was something to be considered gingerly, rates of 30% were considered usurious. In today's markets, where the odious term "debt" has been replaced by the more complimentary sounding "credit," the borrower who is considered a credit risk is charged high rates of interest to compensate the lender.

A thousand years ago, lending was subject to strict restrictions far removed from today's world. When the lord of a manor lent a peasant two bushels of wheat and demanded two and a half bushels in return, the transaction was considered ordinary and lawful business. But when a moneylender demanded 25% on a cash loan, the interest was considered extortionate even though it was the same as the lord's percentage rate. If the peasant could not repay, there were ordinary legal remedies against him and the lender was protected. But the moneylender was in a more precarious position. Charging interest on cash loans was the province of the idle rich or minority groups in Europe, and moneylenders had to be careful

because their activities, begrudgingly accepted as necessary in Europe, had little redress. Shylock did not win his case. Lenders could never be assured of protection under the law.

During the Renaissance and Reformation, debt became a more practical, commercial affair. The Italians made a good living from banking and became the best examples of the new leisure class that lent money while avoiding what was known as real work. The great banking houses became the first examples of making a living by investing in intangibles. When the modern banking houses of Rothschild and Baring were founded in the late 18th century, they capitalized on a tradition built by the Lombard bankers before them. It was now possible for heads of state to borrow money discreetly rather than hock the crown jewels for urgently needed cash.

For over 1,000 years, the distaste for usury and interest remained in place. Ideas about indebtedness and interest then began to change in the early 19th century. Developments in the United States would prove crucial to the acceptance of debt in the 20th century, especially with the long history of bias that had become deeply ingrained in Western European and American practice. The British perpetual war loans, incurred after the defeat of Napoleon, changed the perception of large-scale government borrowings. And the passing of bankruptcy laws in the early 19th century began the slow trend toward the general acceptance of debt as a necessary sin that could be remedied. Another subtle change was that usury was defined as *excessive* interest, not simply interest itself.

After surviving as a prohibition for years, the charging of interest

underwent a profound change after World War II. A dramatic increase in population provided for easier credit for the masses, especially in the United States, and a relaxed attitude toward indebtedness in general. A subtle shift occurred. Those in debt were referred to as having received credit, or “leverage.” The newer version of the old concept made it more palatable to be in debt because now the borrower was being extended credit, as if being given a gift. Personal and corporate indebtedness grew to levels never anticipated 50 years before.

“If a man owes a bank a dollar and cannot pay, he has a problem. If he owes it a million and cannot pay, it has the problem.”

— Mark Twain

In the contemporary world, the debate still rages about usury, but without the moral overtones. The levels of personal and corporate indebtedness in the United States have risen to historic highs. In the recent financial crisis, it finally has been admitted that the precipitous asset value drops were the result of the reduction in debt by borrowers. Although some originally believed that these levels of indebtedness were sustainable, the chance of a severe depression or recession caused by rising interest rates became more likely as the economic cycle shifted toward rising energy prices and slow economic growth, conditions similar

to those last witnessed in the 1930s and 1970s.

The amount of debt financing began humbly but grew to be very large within 20 years. In the 1950s and 1960s, borrowing was still considered somewhat risky, depending on the income of the borrower. But when in the early 1950s Franco Modigliani and Merton Miller published their now famous hypothesis that a firm’s debt levels were coincidental to its ability to make money, the old prohibitions began to crumble at the corporate level. The door now was open to higher levels of leverage

in the United States. A revolution had begun. Corporate indebtedness increased, and the short-term commercial paper market grew rapidly. With it, consumer credit also exploded because the resurgent commercial paper was used to fund banks’ activities in creating credit card debt, a uniquely American innovation from the start.

This credit revolution, beginning after World War II, took hold faster in the United States than in other industrialized countries. The general acceptance of credit cards and extensive corporate

credit facilities helped fuel the world’s largest consumer-driven economy and enabled it to maintain its premier position as the world’s economic engine. America quickly was on its way to becoming a buy-now-pay-later society rather than the save-now-buy-later society it had been before the war. As a result, consumer and corporate indebtedness reached historic levels. Personal levels of indebtedness also became a factor when setting the course of monetary policy. Indebtedness now was an integral part of climbing the economic ladder.

The sheer size of the indebtedness acquired on corporate balance sheets

eventually required a market where interest rate risks and currency risks could be laid off. As a result, the swap market was born in the 1980s. Institutional investors and corporations could exchange cash flows based on different types of interest rates. Most did this for hedging purposes, but others did it simply for speculation. Regardless of the intent, swaps proved that debt finally had become fungible and marketable. This marked another turning point in the history of debt. If the concepts had been around 400 years earlier, Portia would not have had to intervene at the debt trial of Antonio in *The Merchant of Venice*. All she would have had to do was swap the onerous debt owed to Shylock for something based instead on Antonio's future cash flows. If that did not work, then that pound of flesh could have been securitized, sliced into tranches, and sold to other investors.

These new markets, especially the swap market, have made the wholesale trading of debt routine. Most of the old prohibitions against incurring debt were swept aside in favor of increased levels of leverage that could be traded in a secondary market, much like stocks or foreign exchange. As a result, credit became easier to obtain than at any time in history. Easy money found its way into the retail sector as consumption continued to be more important than indebtedness in driving the economy. With interest rates deregulated since the mid-1980s, trading debt-related derivatives was possible and quickly grew to become the fastest growing financial market ever witnessed.

The recent developments in the mortgage industry could not have been possible without securitization. The ability to bundle residential mortgage loans and other forms of indebtedness and use them as collateral for bond borrowing allowed banks to keep their balance sheets clear of many previously created loans and to

continue generating credit. The original type of securitization, applied by Fannie Mae, Ginnie Mae and Freddie Mac in the 1970s, became a standard tool for repackaging mortgages and consumer debt for eventual sale to bondholders. After 2001, the technique became so widespread that the value of the collateral was overlooked in favor of creating even more debt-backed securities, leading to the credit market crisis beginning in 2007. Securitization became the favorite way to fund subprime mortgages and other forms of debt, planting the seeds for the economic crisis that followed.

Securitization also helped create a new generation of mortgages, many of which had never been seen before as retail financial instruments. Adjustable-rate mortgages (ARM), many with sweetener grace periods; balloon payments; negative amortization loans; and reverse mortgages, to mention but a few, all became increasingly popular after the recession in 2001 as homeowners rushed to buy property or to "unlock the equity" in their homes. This great mortgage boom was propelled by a lack of fear for the consequences of potentially rising interest rates and personal debt ratios. Politics played a central role in minimizing the consequences of individual debt. Once interest rates started to rise, the damage to the mortgage market was widespread because many of the loans were originated under very loose lending practices. Then politics struggled to find an answer to the problem.

Although debt and interest rates have been thoroughly retooled and modernized over the last two centuries, the notion of usury is not totally dead in the contemporary world. It is rearing its head again as it becomes clear that many homeowners could not service the interest rates on their loans, creating collateral damage in the derivatives markets and the banking industry. Many of those same hom-

owners would be surprised to learn that the pesky ARM is only about 25 years old. Its appearance finally put an end to the usury laws because in 20th century America they applied only to fixed-rate residential mortgages. As the history of consumer and mortgage credit shows, the ARM is really an application of consumer credit applied to mortgages. Revolving credit, originally offered by credit cards, helped revolutionize the housing market and then nearly destroyed it.

Underlying these revolutionary trends in finance has been a practice that will be referred to as "cannibal consumption." This consumer practice helped destroy the housing market and consumer credit market because the links between them had become so intertwined. Consumer debt rose from what today seems a meager \$6 billion during World War II to over \$2.5 trillion today. When consumer debt became too onerous, many households used mortgage refinancing to continue their consumption patterns. Consumers were not only eating out more frequently than in hard times, they were also eating the family residence in the process.

The old admonitions against debt and usury still ring true today. As Mark Twain once remarked, "If a man owes a bank a dollar and cannot pay, he has a problem. If he owes it a million and cannot pay, *it* has the problem." If that happened today, the lender's bank would probably sell some of that debt to another bank, which would buy it with money borrowed at 40 times its own capital. To Mark Twain's admonition we may add this: If a bank owes another bank a billion and cannot pay, *everyone* has a problem. **EH**

This article is excerpted from Collateral Damaged: The Marketing of Consumer Debt to America by Charles R. Geisst, published by Bloomberg Press, 2009.

Declaring Financial Independence

By Gregory DL Morris

LIVING THROUGH HISTORY makes it nearly impossible to see the forest for the trees. How many people have wondered over the past 18 months, “is this what the start of the Great Depression was like?” The collapse of big name banks and brokerage houses has been impossible to miss. But what is not so obvious is the effect on the other investment channel, the independent financial analyst. Even though the decline in asset values has been near-universal, initial reports indicate that the independent model is holding up well.

Mark Tibergian, CEO of Pershing Advisor Solutions, based in Jersey City, NJ, notes that while several major Wall Street names have been laid low by the current recession, that process has been underway for some time. “Just the other day I looked at a magazine from when I started in this business in the early 1970s, and most of the advertisers—like Kidder Peabody and E. F. Hutton—were already long gone. The growth in the advisory business has been among independents, not among the name firms.”

That trend has been accelerating, Tibergian adds, by all measures. “The transfer of assets has increased in velocity, but we are also seeing significantly more people who used to work at the big-name firms create their own independent firms.”

That is resonating with investors, says Tibergian. “At one time people wanted to run with the herd, but we have just seen that can be a herd of



Rebecca Pomeroy of Moss Adams has been a pioneering researcher in landmark studies on how independent advisors can improve their practice.

lemmings running straight over the cliff. We have also found that the only reputation that can be transferred is a bad one.” He also notes that some independent practices are now becoming as big as some of the smaller broker-dealers that serve that sector.

“The financial devastation has definitely changed the way that advisors do business,” says Elizabeth Nesvold, managing partner at Silver Lane Advisors in New York. “It used to be simple for someone to hang out a shingle for a one- or two-person oper-

The demise of big-name institutions accelerates the rise of independent advisors

ation.” She recalls that in the 1970s and 1980s advisors came out of the wirehouses and either went with a product manufacturer or out on their own as advisors. That shifted to either multi-family offices for wealth advisors, or relationship managers with open architecture.

“Now huge blemishes in the system have come to light,” says Nesvold. “So is open architecture dead? No, but it will require a much different level of service, more transparency, and clearer ownership of assets.” As a result, she expects margins to be lower, and regulation to be more costly and onerous. “Advisors are having to re-examine their business models in light of the new realities for profitability.”

Silver Lake puts together transactions where advisory firms buy, sell and merge with each other. “There is definitely a growing trend to amalgamation,” says Nesvold. But the traditional buy-sell approach has not gone away, she adds. Surprisingly, value of the franchises has not diminished much either. “There is greater demand for services, and fewer clients to go around. The new model is a firm big enough to deliver resources but small enough to have meaningful personal contact.”

The public wants choices, says Jeanne Brutman, a financial advisor based in New York. But choices mean decisions, and for that they need guidance and education. “Often people don’t really understand diversification. People thought that if they were with several different houses, or held several different funds, they were diversified.” In reality, she explains,

those different firms or funds were often investing in many of the same instruments.

Brutman also notes that the most important part of financial planning is not the planning itself but the execution. “There are lots of brochures with pretty graphs and charts that are all approved by compliance, but what clients really need is a nag to get them to implement the plan.” She says it is a lot like being a parent: you bug them because you care about them.

That takes a lot of time and effort, rare commodities at a time when profitability is tough. But the outlook is not so bad for most advisors, despite the recession. Brad Buermann, executive vice president of FP Transitions, based in Portland, OR, concurs that valuations for advisory business have not declined in the recession. His firm helps advisors make long-term succession plans for their businesses, from rising stars within the organization, or bringing in outside leadership, or selling the business. And business has been brisk. “We are getting 40 inquiries for each listing and multiple offers,” he says. “Multiples have been the same as before the recession, and in some cases even higher. That tells me that financial advisors have evolved to be more than just stockbrokers.”

Buermann notes that “the advisors who are gaining share have a strong planning component.” On the other side of the equation he adds that “I hear from our broker-dealer clients that they are losing people off the bottom. The marginal producers are finding the going too tough.”

One of the main drivers for all these trends, says Tibergian at Pershing, is that “if you are at a bank or a wirehouse, you are really on the sell side. You get paid by the investment. If you are independent, you are on the buy side. You get paid by the client, you have open architecture, and you have your choice of custodian. That is very compelling.”

He further explains that the trends are accelerating during this recession so much faster than during the six previous downturns through which he has lived because, quite simply, “the pain is so much worse this time around. The dot-com bubble, for example, was simply a matter of false pricing in one market sector. The current recession is across all sectors and around the world. And large firms with many moving parts have been affected more severely.”

Pershing LLC, the largest clearing firm in the world with about \$715.8 billion in assets held in custody, was founded on January 1, 1939 as Pershing & Company and boasted \$200,000 in capital. The firm’s original senior partners were Van Burger, Sr., Ed Cohan, Lou Froehlich, Dave Foster and its namesake—Warren “Jack” Pershing, the only son of celebrated WWI General of the Armies, “Black Jack” Pershing. Parent company Bank of New York Mellon, founded by Alexander Hamilton in 1784, is celebrating its 225th anniversary this year. (The Museum is housed in the former Bank of New York headquarters at 48 Wall Street.)

Moss Adams Wealth Advisors, based in Seattle, is one of the new



*Left: Elizabeth Nesvold,
managing partner at Silver Lane Advisors.*

Right: Stephen Horan of the CFA Institute.

firms formed by advisors out of a big-name firm, but with a major twist: Moss Adams is one of the leading consulting firms to the financial services sector, and Rebecca Pomeroy was a pioneering researcher in landmark studies on how advisors, especially independent advisors, could improve their practice. The parent company published its annual "Compensation and Staffing Study" in September.

In July 2008 Pomeroy established Moss Adams Wealth Advisors as an independent wealth management practice affiliated with the parent firm. Her vision and her ambition could not have been clearer, and her timing could not have been worse. "We had \$800 million in assets under management at inception, and \$700 million by the end of year. Whether advisors were strategic or tactical there was no place to be safe anywhere across all research platforms. I cannot imagine a downturn harder than this one," she says.

Proportionally, a loss of 12.5% was a shining accomplishment in a market that fell by half and at a time when the quip on the Street was "down 20% is the new flat." But still, \$100 million dollars in wealth is not like losing change in the couch. "We are back to about \$750 million now,"

says Pomeroy, "but we did have to have some reduction in staff."

Most importantly her faith is not shaken. "Some advisors will make changes, but the structure of the independent model is not broken. Clients' needs have changed, but the fundamentals of the business and the productivity metrics have not changed." Pomeroy is still worried about excess, but now it's excessive regulation and excessive fear in the market.

There is also a concern that the basic pricing mechanism in the business may be flawed. "Getting paid as a percentage of assets under management means that in rising markets, when assets grow fastest, advisors get paid more even though their services may be needed less," Pomeroy says. "When markets fall and clients most need guidance, assets decline and advisors' pay goes down. The challenge is to align the compensation structure with the true service to the client."

Another measure confirms the observations that the recession is accelerating the influx of both advisors and assets to the independent wealth-management channel: the number of people with certification in the field. The Certified Financial Advisor designation, administered by the

CFA Institute in Charlottesville, VA, is one of the oldest and most-respected accreditations an individual advisor can hold.

Stephen M. Horan, head of professional education content and private wealth for the institute, notes that the number of advisors registering for the CFA examination in the most recent fiscal year was higher than ever. "That is counter-cyclical, but people tend to defer the decision to go out on their own or to seek certification until there is some event or milestone, and this recession is more severe than previous ones. Advisors are questioning how to position themselves, and how to respond to clients and prospects who are asking 'how do I know you're not Bernie Madoff?'"

Training and certification are one way. But Horan acknowledges that there is still "an alphabet soup problem. The public is still not clear on which designations mean what." Before the bust, clients were most interested in yield, Horan explains. "Alpha" was on everyone's lips. "Now clients are more conservative, but there is more to wealth preservation than risk premiums and bond spreads."

Horan says the fundamental change he is observing in the advisory business

Left: Jeanne Brutman,
a financial advisor based in New York.

Right: Mark Tibergien,
CEO of Pershing Advisor Solutions.



is that some advisors are now viewing clients' objectives in life—house, college education, travel, retirement—not as goals but as a string of liabilities to be funded. They are thinking like pension-plan managers who have certain financial obligations to meet at certain times in the future and deploy assets to meet those obligations.” The term is to “defease,” which means allocate today against known future liabilities.

In January of 1947, four financial analyst societies—Boston Security Analysts Society, Investment Analysts Club of Chicago, New York Society of Security Analysts and Financial Analysts of Philadelphia—joined forces to form the National Federation of Financial Analyst Societies. The name was later shortened to the Financial Analysts Federation, or FAF, and in 1990, the FAF merged with the Institute of Chartered Financial Analysts, or ICFIA, to form AIMR, now CFA Institute.

In 1945, two years before the foundation of the NFFAS, the first issue of *The Analyst Journal* was published. This publication would eventually become what is known today as the *Financial Analysts Journal*. In its inaugural issue, Benjamin Graham described “the advantages of a rating system” for financial analysts: “The

analyst who qualifies for the rating,” wrote Graham, “will have the obvious advantages of prestige, improved ability to get a job, and the chance for higher pay. In addition, he is likely to develop a more professional attitude towards his work and a keener interest in maintaining and advancing the standards of his calling.”

Other observers continue to offer constructive criticism of the independent advisory channel. One sea changed was marked by Jim C. Otter's book *High Expectations & False Dreams: One Hundred Years of History Applied to Retirement Planning*, published in 2001 after the dot-com bust. Until then it was received wisdom in financial planning that as an individual aged the safe play was to increase the percentage of assets in fixed income.

Otar put the data to the idea that “the math of accumulation and the math of distribution are completely different. During accumulation the problem is volatility,” says Otter. “But once you flip the switch into distribution, the problem is not volatility, it is sequence. In the first four years after accumulation ends, one very bad year, down 10% or more, or two medium bad years, down 5%, or four years at 0%, can cut the life of an accumu-

lated portfolio in half, from 30 years to 16 or 17 years,” Otter explains. That is a serious problem, because with demographic trends showing life expectancies closing in on 90, 30 years of retirement is not just possible but likely.

Otar says few people believed him when he published his original work in 2001. “But I have had a few people thank me for helping them plan. I always answer that I am not giving investment advice, just looking at financial history.” Now that more people are willing to listen, Otter is coming out with a new book, *Unveiling the Retirement Myth: Advanced Retirement Planning Based on Market History*, which is due out in October. **FH**

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For Us or For Them? Bailouts Then and Now

By Robert E. Wright



SHOULD THE U.S. GOVERNMENT, or any government for that matter, use public money to stabilize a disintegrating financial system? Theory backed by historical experience suggests that it should, but only if it does so in just the right way. Financial crises are best avoided as they can have significant negative effects on economic and political systems, not to mention people's lives. Once a crisis is underway, however, government inaction may be better than implementing a bailout hastily cobbled together by politicians and bureaucrats who are anxious to keep their jobs. Bailouts are heterogeneous and differ significantly in their effects. At their best, they ameliorate panic conditions and reduce human suffering, but at their

worst they redistribute wealth from taxpayers to the individuals and institutions most responsible for the crisis and even increase the likelihood of future financial fiascos.

As Table 1 details, the economic impact of U.S. financial crises since 1763 has ranged from mild to traumatic. Real per capita incomes actually rose in the wake of the 1792 panic and shrank only briefly and modestly following the crises of 1818–1819, 1990–1991 and 2000–2001. The Panic of 1873, by contrast, led to six long years of recession, and the financial crises of the 1890s and 1930s spawned depressions long and steep. Financial crises have also created nasty political fallout ranging from major regulatory reforms (1907,

1929–1933, 1990–1991, 2000–2001) to political party realignments (1818–1819, 1857, 1873, 1893–1895) to rebellion and revolution (1764, and almost in the 1930s according to some). Depressing as it is, Table 1 does nothing to capture the horrific human suffering the crises engendered, including the urban riots of 1819, the dispossessed farmers of 1893, the bread lines of 1933 or the subprime despair of 2007–2008.

The distressing length of Table 1 may suggest to some that financial crises are the inevitable byproducts of financial innovation, periodic costs that the economy must suffer to pay for dynamic growth. Although the complete elimination of financial crises is unlikely, the long periods of pros-

Table 1 The Economic and Political Consequences of Major U.S. Financial Panics, 1763–2008

Crisis Year(s)	Causes	Recession Years	Real per capita GDP High (2000 USD)	Real per capita GDP Low (2000 USD)	Percentage Decline (%)	Effects
1764–65	Real estate	1764–1768	n/a	n/a	50% (land prices)	Imperial Crisis and Revolution
1792	Public securities, bank stock	n/a	\$943 (1791)	\$1,030 (1793)	n/a	Hamiltonian financial program continues to develop
1818–19	Real estate, commodities, imports, turnpikes	1819–1820	\$1,330	\$1,315	1	Realignment of the Jacksonian Party; destruction of the Second Bank of the United States
1837–39	Real estate; agriculture; canals	1837–43	\$1,681	\$1,618	4	Wave of state constitutional reforms
1857	Grain; gold	1857–58	\$2,252	\$2,202	2	Republican party solidification and increased sectional animosity
1873	Railroad securities; real estate	1873–1879	\$2,834	\$2,737	3	Rise of labor unions and agrarian reform groups
1893–95	Railroad and other equities	1893–1897	\$4,559	\$3,913	14	Populism; Progressivism; Great Merger Movement
1907	Equities	1907–8	\$5,621	\$4,917	12.5	Federal Reserve System
1929–33	Equities; banks; real estate	1929–1933	\$7,099	\$5,056	29	RFC (1932); FDIC (1933); SEC (1933); SSA (1935)
1980s	Savings and Loans; real estate	1980–82 1990–91	\$23,007 \$28,429	\$22,346 \$28,007	3 1.5	FIRREA and RTC (1989); Riegle-Neal (1994)
2000–1	Equities; corporate accounting	2001	\$34,759	\$34,659	.02	Sarbanes-Oxley (2002)
2007–?	Real estate; subprime mortgages; derivatives	2008–?	\$38,148	\$TBD	TBD	Emergency Economic Stabilization Act (2008); TBD

perity and financial calm that followed the Panic of 1792 and World War II suggest that the tradeoff between crisis and growth, between systemic risk and aggregate output, may not be as stark as some believe. Improved public policies, in other words, may be able to decrease the number and severity of financial crises in the future. In order to affect that happy end, however, policy-makers must develop better theories of why crises occur.

Financial crises are just one of many hyper-dysfunctional or “FUBAR” (Fouled Up Beyond All Recognition) aspects of the economy. Other examples include construction, health insurance and health care, higher education, marriage, mortgages, retirement savings and other lagging sectors where costs increase faster than inflation and quality stagnates or even degrades. Those on the Left tend to trace hyper-dysfunction to market failures like asymmetric information (e.g., adverse selection, moral hazard), asset bubbles (e.g., housing prices in the 1760s, 1920s, and 2000s), externalities (negative like pollution and positive like education) and public goods (e.g., national defense, funding for basic scientific research). Those on the Right, by contrast, typically find fault with the government, particularly the lack of bureaucratic accountability and the futility of central planning.

Explanations of the subprime mortgage crisis of 2007 and the great crash of 2008 follow that same predictable pattern. Democrats usually blame the crises on unscrupulous and manipulative financiers who by hook and by crook tricked the government into repealing crucial financial regulations and modifying important accounting rules. Republicans typically argue that the government caused the crisis by keeping interest rates too low for too



Secretary of the Treasury Alexander Hamilton implemented “Hamilton’s Rule” in response to the Panic of 1792.

long, by pushing lenders into making risky loans to low-income borrowers, and by reducing the effectiveness of private monitoring by foisting weak public substitutes like the Securities and Exchange Commission on unsuspecting investors.

Both sides are partially correct but they miss the essence of the problem – that market and government failures *combined in complex ways over long periods of time* to cause the crash. The failures were hybrids, partly government and partly market in origin; many of them were put into motion decades ago. The mortgage interest deduction, for example, is as old as the modern U.S. income tax system itself. The deduction’s distortion of savings decisions (away from building home equity and toward investment in securities markets) grew along with rising marginal tax rates, the advent of home equity lines of credit and easy refinancing terms, and tax preferences for 401K and similar retirement plans. The government basically paid people to mortgage their homes to the hilt

and invest in the stock market so it isn’t surprising that many did so, with plenty of help from financial institutions eager to win their business.

Ill-conceived compensation structures were another type of hybrid failure that fed the financial crisis. Between the Civil War and World War II, six U.S. mortgage securitization schemes failed because mortgage originators received their full commissions at closing, which rewarded them for authorizing loans to anyone and everyone rather than for screening the level of risk. Life insurance regulators squelched an analogous problem by mandating that agents’ commissions be spread over five or more years. Despite those clues, regulators allowed the mortgage misalignment to recur in the Third Millennium. They also allowed

investment banking partnerships to go public without considering the crucial role that ownership structure plays in managerial risk-taking. Partners’ wealth was mostly tied up in their firms, so they were inherently more risk averse than were mere managers compensated largely on the basis of short-term and often illusory accounting gains. Especially in the wake of Enron’s failure, regulators should have realized that the temptation to generate the appearance of short-term profits, which is easily done via any number of accounting techniques, would prove too strong for many managers to resist given the immense size of the annual bonuses at stake.

Government-sponsored enterprises (GSEs) are another obvious example of hybrid failure. Founded as a government agency in 1938, the Federal National Mortgage Association (Fannie Mae) for three decades provided liquidity to mortgage lenders by buying their safe mortgages, then securitizing and selling them to investors. The

Museum of American Finance

Table 2 The Consequences of Different Types of Government Bailouts

Reaction	Risk	Profits	Examples
1a. do nothing — won't	Not socialized: government does not feel that it is appropriate or prudent to do so.	Private	• Enron, 2001 • Superior Bank, 2001 • Lehman Brothers, 2008
1b. do nothing — can't	Not socialized: government is unable to do so for ideological and/or institutional reasons.	Private	• Banking crises in 1819, 1837–39, 1857, 1873, 1884, 1893–93
2. broker a private rescue	Not socialized: government uses its power to induce private parties to aid troubled companies.	Private	• J.P. Morgan, 1907 • National Credit Corporation, 1931 • LTCM, 1998
3. favoritism	Not socialized: government endows troubled companies with a competitive advantage such as a protective tariff or regulatory forbearance.	Private	• Bank holiday of 1933 • Life insurer forbearance, 1930s • Savings and Loan Crisis, Phase 1 • Steel tariffs, 2002
4. cash grants	Socialized: government directly subsidizes distressed entities with cash.	Private	• Airline industry, 2001 • merger sweetener (cash to acquirer) • payoff (cash to uninsured creditors)
5. loan guarantees	Socialized: government guarantees the debts of troubled companies.	Depends on details	• Lockheed, 1971 • Chrysler, 1979 • GSEs
6a. lender of last resort—modern central bank rule	Socialized: government loans to distressed companies and industries with indifferent collateral at a subsidized rate.	Mostly private	• Stock market crash, 1987 • Currency and sovereign default crisis, 1997–98 • Y2K, dotcom bubble burst, 9/11, 1999–2002 • Subprime mortgage crisis, 2007
6b. lender of last resort — Hamilton nee Bagehot's Rule	Socialized: government loans to distressed companies on good collateral at a penalty rate.	Mostly public	• Panic of 1792 • Reconstruction Finance Corporation, Phase 1
7. troubled asset purchases	Socialized: government purchases the troubled or illiquid assets of distressed companies	Private/public	• FDIC assumption of bad bank debts • TARP, Phase 1
8. equity investor of last resort (partial nationalization)	Socialized: government purchases equity stakes in distressed companies.	Private/public	• Reconstruction Finance Corporation, Phase 2 • Continental Illinois, 1984 • TARP, Phase 2
9. conservatorship	Socialized: government owns bankrupt companies with the intent of winding down their operations and selling their assets in a controlled fashion.	Public	• Bridge banks, e.g. First Republic Bank of Texas, 1988 • Resolution Trust Corporation, 1989 • Fannie Mae and Freddie Mac, 2008
10. full nationalization	Socialized: government owns troubled companies with the intent of owning and operating them, though it may privatize them later.	Public	• Conrail, 1976–1987 • Amtrak, 1971–ongoing

system worked well, but in 1968 the government decided to get Fannie off its balance sheet because it was under pressure from the budget deficits associated with the Vietnam War and President Lyndon B. Johnson's "Great Society" programs. Two years later, the government created a second publicly-traded company, the Federal Home Loan Mortgage Corporation (Freddie

Mac), to compete with it. The pair were tagged GSEs because the government implicitly guaranteed their debts, a lucrative arrangement that allowed them to borrow much more cheaply than other corporations could.

The GSEs were also allowed to maintain a leverage ratio of 40 to 1 (\$40 in assets for every \$1 in capital), an extremely aggressive level envied

even by hedge fund managers. The GSEs were therefore extremely profitable and hence powerful forces in Washington, which generally couldn't get out of their way fast enough. The biggest irony of the 2007–2008 crisis was that the very institutions most clearly backed by the full faith of the U.S. government were among the

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The Bank of Columbia: Toxic Assets in the Federal Period

Irresponsible lending and over-friendly relations between banks
and government date to the earliest days of the republic

State of Maryland to wit. Know all men by
these presents that I William Pinkney of the City
of Baltimore have constituted and appointed and
do by these presents constitute and appoint William
Wharin Esquire Casheer of the Bank of Columbia
my attorney to Transfer and make over to
Ninian Pinkney of the City of Annapolis three
of the shares standing in my name on the books
of the Bank of Columbia, hereby ratifying and
confirming all that my said attorney may
lawfully do in the premises, In witness
whereof I have hereunto set my hand and
Seal this Twenty fifth day of June in the year
of our Lord one thousand Eight hundred
and five

Witness & acknowledge before
John Davidson a Justice of the peace for
said County

WILLIAM PINKNEY
STATESMAN, DIPLOMAT, LAWYER

BETWEEN 1790 AND 1830, the newly-formed United States of America experienced changes in almost every aspect of life. Colonies of England no more, the young nation established a system of republican government. Debates over the merit of a strong central government, a funded debt and paper money raged through the states. Alexander Hamilton, the first Secretary of the Treasury, lobbied for the commercial interests of the young nation, and soon these commercial interests began to dictate the national conversation.

American merchants continued to trade across the Atlantic while new trading patterns developed at home. Easterners looked to western markets as a source of goods and food, and construction of a rough system of turnpikes and canals began primarily in the north.

A central Bank of the United States (BUS) was integral to Hamilton's plan. The charter for the first BUS ran from 1792 to 1812, and was not renewed primarily because agricultural interests in Congress opposed it. The War of 1812 left the nation's finances in a shambles, and a second BUS was chartered in 1816, again for 20 years. Renewal was again opposed, this time on populist grounds by President Andrew Jackson. It is ironic that such an opponent of sound money should now glower at us from the \$20 bill. During the tenures of the two Banks of the United States, they issued paper money, as did many state and local banks. Non-BUS notes usually traded at some discount to face value, but hard coin was almost always preferred to paper money.

In 1790, the nation's leaders decided to locate the capital city between Maryland and Virginia along the banks of the Potomac River; yet unlike New York or Philadelphia, the city of Wash-

ington did not yet exist. The area for the District of Columbia was 10 miles square, and the plot of land included the existing towns of Georgetown, MD, and Alexandria, VA. This newly-planned city of Washington, District of Columbia, would become a microcosm for the changes sweeping through the young nation. Local businessmen were excited about the economic opportunities. Commercial and financial speculation raged through the capital city, and businessmen invested large sums of money in speculative ventures.

Building the new city took more than just constructing houses: purchasing land and constructing buildings required capital. The commercial success of the city depended on a reliable infrastructure of roads and canals. Within the new city, the chartering of the Bank of Columbia in December 1793, and the recapitalization of the Potomac Canal Company (legally known as the Potomac Company) in the early part of 1796, reflected these larger national trends. The Bank of Columbia issued bank notes, granted loans to real estate investors and paid dividends to its stockholders. The Potomac Company constructed a system of canals to transport goods, such as whiskey, flour and iron from the region of Ohio to be sold in the District of Columbia, as well as exported to Europe.

To encourage development in the city of Washington, urban planner Pierre L'Enfant held a public land auction in October 1791. Although President George Washington, Secretary of State Thomas Jefferson and Congressman James Madison attended the auction, only 35 of the available 10,000 lots were sold. Auctions in 1792 and 1793 yielded similar results. It seemed the general public wanted little to do with building the nation's capital. Rather, a few prominent local businessmen, including Daniel Carroll of Duddington, Robert Brent, Benjamin Stoddert, William Deakins, Jr. and Tobias Lear seized the opportunities to promote civic pride, and at the

same time increase their own fortunes within the new city.

Another important figure in the early history of the nation's capital was John Mason (1766–1848). Mason invested his energies and finances in two of the capital's burgeoning industries—banking and canal companies. Many of the aforementioned land owners and merchants invested in these two ventures as well. As early as 1793, Mason was an incorporator of the Bank of Columbia, and by March 1796 his involvement with the Potomac Company landed him on its Board of Directors. Although neither venture proved financially viable in the long run, there is much to be learned from them, and the story of the Bank of Columbia has many lessons for today's economy.

John Mason

His father was George Mason of Gunston Hall, VA, an influential member of the Virginia House of Burgesses and representative to the Constitutional Convention. George Mason was a very wealthy man, and he used his wealth and influence to provide for his sons. The senior Mason furnished his first three sons with large plantations, but even as early as the 1780s, George Mason saw a decline in plantation farming and steered his younger sons, John and Thomas, toward careers in business.

After an education under private tutors in Maryland and Virginia, John Mason entered an apprenticeship to the Alexandria, VA merchant William Hartshorne in 1786. Hartshorne and Mason would later work together in the Potomac Company, Hartshorne serving as the company's treasurer and Mason as a director. Between 1788 and 1792, Mason worked in France for the mercantile firm of Fenwick, Mason and Co., and in 1792 returned to Georgetown to manage the firm's domestic affairs. His real estate portfolio included a townhouse on what today is M Street, a ware-

Opposite page: Transfer of three shares of the Bank of Columbia by William Pinkney of Baltimore to his brother, Numan Pinkney, of Annapolis, dated June 25, 1805.

house and a wharf, as well as some lots in Carrollsbury, the town along the Eastern Branch founded by Daniel Carroll of Duddington.

After his father's death, he inherited the rights to the ferry at Rock Creek, Mason's or Analostan Island, and approximately 4,000 acres of land in Fairfax and Arlington, VA. John Mason became active in the affairs of Washington, DC and was sometimes referred to as General Mason, as he served as a general for the District of Columbia Militia and as the Commissary General for Prisoners of War during the War of 1812.

John Mason never served as an elected official but accepted political appointments as a Justice of the Peace for the county of Washington and as the Superintendent for Indian Trade for the District of Columbia. Instead of politics, he pursued economic and commercial ventures in the name of civic good and personal financial gain.

The Bank of Columbia

In the 1790s many wealthy men placed high hopes in the future of banking. Local banks received their charters from the state, and Alexander Hamilton's project, the Bank of the United States, received its charter from Congress in 1792. A wave of financial speculation swept the country, and John Mason caught this wave. Writing to a friend in 1792, Mason asked, "and have you heard of the new game, the paper money speculation! I have lately been playing."

In 1791, prominent Alexandria businessmen chartered the Bank of Alexandria in the state of Virginia and John Mason was an early shareholder in the Bank. Across the Potomac, two wealthy Georgetown landowners, Samuel Blodgett and Benjamin Stoddert, continually schemed for ways to simultaneously promote urban development and make a personal profit. In the spring of 1793, Blodgett proposed a lottery to build a hotel in the federal

city. The venture failed and the lottery speculators lost money, yet Blodgett had countless ideas when it came to making money. Later that same year, he and Stoddert presented a plan for a bank to many of the original investors in the hotel lottery. Excited by Blodgett's plan and not to be outdone by their Alexandria neighbors, the Georgetown elite supported Blodgett's plan for a bank.

The Bank of Columbia received its charter from the State of Maryland in December 1793. Blodgett served as its first president. He believed that every town with 7,000–8,000 inhabitants should have a bank with a capital of \$1 million. Georgetown had half that number of people, yet double the amount of faith in this venture. The Bank of Columbia was based on high hopes, not economic reality. The bank's first incorporators included Benjamin Stoddert, William Deakins, Jr., Uriah Forrest, John Mason, James Maccubbin Lingan, Francis Lowndes, Marsham Warring, Peter Cassanave, William Magruder, Joseph Forresst, Thomas Peter and John Templeman.

Several of these men also held positions within the federal city coinciding with their involvement with the bank. The bank's charter made no provisions against bank officers serving as public officials. Stoddert and Deakins purchased lots for federal buildings, and Deakins was treasurer of the Board of Commissioners while he was the bank's cashier. During John Mason's tenure of as the bank's third president, he also served as General of the District of Columbia's militia.

The bank's charter was very lenient. Subscriptions to the Bank of Columbia cost \$100 per share with the payments spread over a seven year period. Most banks at that time, such as the Bank of the United States and the Bank of Alexandria, had charters that expired after a set time period, usually 20 years. The charter for the Bank of Columbia was perpetual.

The Bank of Columbia catered to

the needs of the new city's financial elite. Essentially a private corporation, it was not required to file an annual report to either the state or Congress. The bank had a two-fold purpose: to issue bank notes and to grant loans especially to the stockholders and the city's commissioners. The Bank of Columbia often issued blank checks for the commissioners to purchase land. Also, the city commissioners encouraged the bank to lend money to large land speculators such as James Greenleaf and Robert Morris. Prior to John Mason's tenure as president of the bank, the Bank of Columbia already granted large loans to the city's commissioners, to private land speculators and to the Potomac Company. Robert Morris and James Greenleaf became extensive landowners in Washington, DC after promising to make improvements on their lots within two years of purchasing them in an effort to attract residents to the new city. In 1794, Greenleaf purchased 857 lots with the help of the commissioners and the bank. The Commissioners were so dependent on Greenleaf's investment they asked the bank to treat him favorably. When Greenleaf could not pay off his loans, the commissioners arranged for the bank not to penalize him for a late payment.

The stockholders of the bank elected John Mason as its president in 1798, perhaps due to his social position rather than his banking expertise. He remained in that capacity for 18 years. Mason was upset with the Bank's policy of granting blank checks to the city's commissioners, and he soon ended that practice.

The early 19th century was an interesting time for the banking community in Washington, DC. Twenty year bank charters began expiring in 1811, and banks were seeking alternatives in case their charters were not renewed by either the federal or state governments. The charter for the Bank of the United States was set to expire in March of 1812, and since

the charter was not being renewed by Congress, Treasury Secretary Albert Gallatin needed to invest the Treasury's funds elsewhere.

As early as February 1811, Gallatin began transferring business to the Bank of Columbia. Some government officers, including the Secretaries of War and Navy, began to draw their salaries from the Bank of Columbia. In March of that year, Gallatin wrote to John Mason inviting him to establish a branch of the bank in the Treasury building. The Bank of Columbia has the distinction of being the only bank ever permitted to maintain a branch of its business in the Treasury Department building. According to Gallatin, this move would ensure the continued relationship between the bank and the Treasury Department. Mason granted Gallatin's request, as the success of this bank depended on the move.

The employees of the Bank of Columbia spent much time and effort conducting the business of the Treasury. This soon led to their financial downfall. During the War of 1812, the bank issued \$80 million worth of bonds and notes to finance the war; the bank only received payment of \$34 million. After the war, banks nation-

wide suspended specie payments, and the value of paper money depreciated. The Bank of Columbia accepted the devalued money as a repayment of its war loans, thus the loans were never fully repaid.

While the Bank of Columbia was busy conducting the business of the Treasury, the District of Columbia was going "bank mad." Some of Washington's financial community, upset by the Bank of Columbia's exclusive relationships with large landowners and the Treasury, set about chartering a new bank. John Tayloe and John VanNess were among the directors for the newly-established American Bank. The Bank of Columbia still kept a roster of preferred customers. Rather than subscribe to the American Bank, Francis Corbin wanted stock in the Bank of Columbia because of its perpetual charter. In 1812 Corbin wrote to John Mason, "Your bank can never die and it is out of reach of all State or Congressional Quacks who might, if they had anything to do with it, poison it to death by their Nostrums."

John Mason remained president of the Bank of Columbia during and shortly after the War of 1812, but in 1816 Nathaniel Frye was elected pres-

ident. The bank was not profitable during Mason's presidency and continued to struggle under Frye's leadership. From the beginning, the bank's directors not only overextended credit to wealthy land speculators, but to their own directors as well. Benjamin Stoddert was both a land speculator and a shareholder in the bank, and it lent him an almost unlimited supply of credit. Stoddert bought several lots in the District of Columbia with loans from the bank, but by 1820 necessity forced him to mortgage to the bank 2,000 acres of land in Prince George's County, MD, and his home and square in Georgetown. The Bank of Columbia foreclosed on his mortgage that same year. In 1825, the Bank of Columbia closed its doors after "32 years of bad management, neglect and confusion." **FH**

Meg Ventrudo received her MA in American History from George Mason University in Fairfax, VA. She worked at the Museum of American Finance from 1994-2004, where she was the assistant director for exhibits and education. She is currently the executive director of the Jacques Marchais Museum of Tibetan Art in Staten Island.

Wall Street and the Dust Bowl

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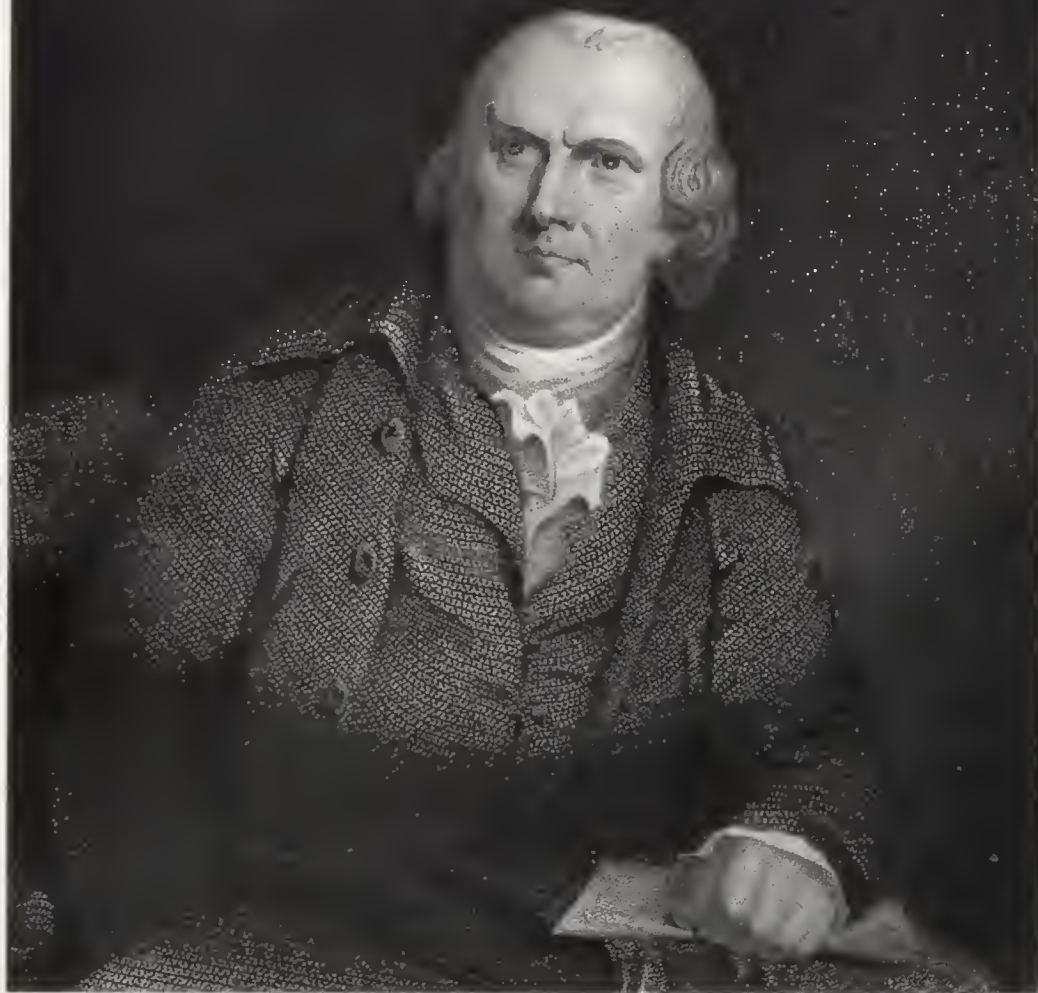
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The Financier

Robert Morris, America's Original Bailout Czar



Museum of American Finance

By Ray Raphael

THERE WERE NO second or third choices. Everyone knew that only one man could possibly save the failing nation. Like him or not, and many did not, members of Congress begged the richest man in the country to reverse the worst financial crisis in American history.

The year was 1781, and a Continental dollar could not buy a penny's worth of goods. Unless suppliers and lenders could be persuaded to accept Congress's money or credit, there would be no beef or flour for the troops and no powder for their guns. Soon there would be no Army, and

in the end no nation. The American experiment with independence, just five years in the making, would be no more than a brief episode in the history of the British Empire.

Before coming to the rescue, Robert Morris pushed Congress to grant him powers that no President has ever enjoyed. He could handle all money without oversight, dismiss any government worker at will, import and export on the nation's tab, negotiate with and borrow money from foreign governments on his own accord, run the Navy, and simultaneously continue to build his private fortune. But he did come through. Merchants

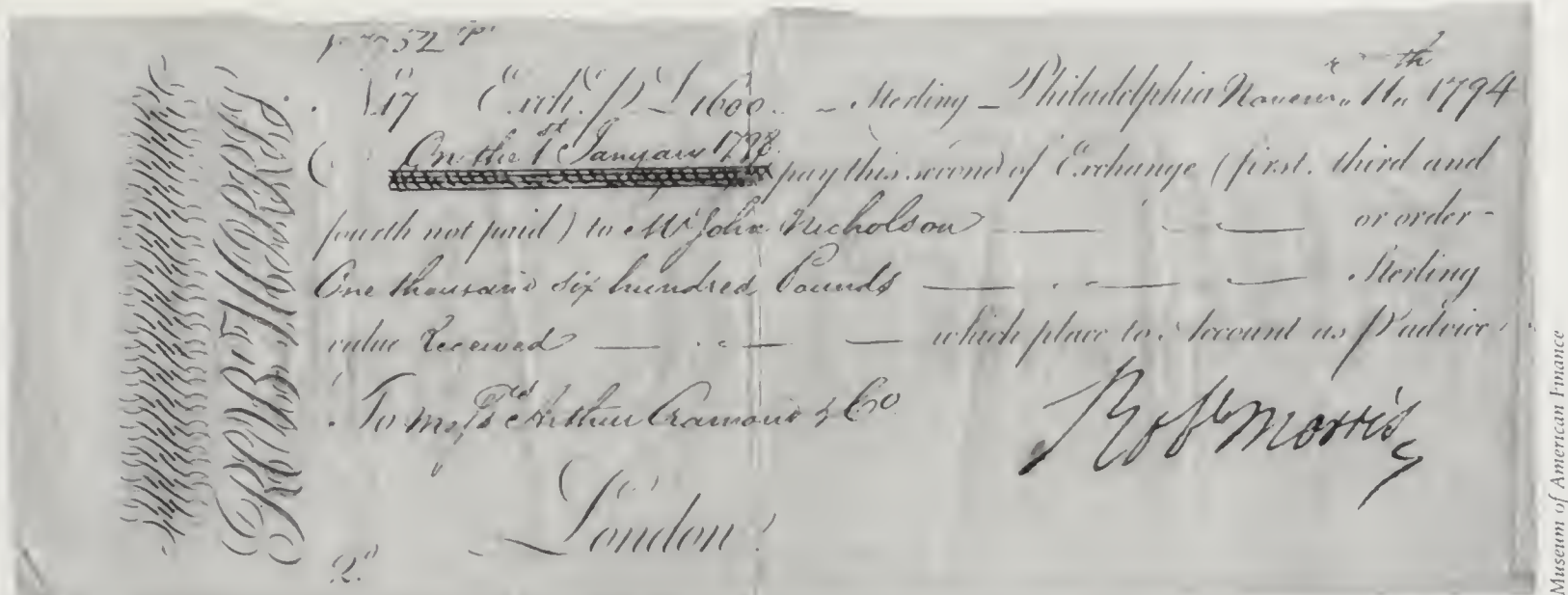
who refused to deal with a floundering Congress were willing to do business with "The Financier," as he was called both at home and abroad. They would not accept Continental currency, but they would take "Morris Notes," which were treasury bills backed by his own personal credit. If the government could not pay, Morris himself promised he would.

So why don't many people know this man?

Born in Liverpool in 1735, Morris came to the colonies at the age of 12 and apprenticed with Charles Willing, one of Philadelphia's leading merchants. At age 15, while his boss was traveling abroad, the young clerk cornered the Philadelphia flour market, thereby inducing scarcity and raising prices. Consumers were upset, but Charles Willing, upon his return, praised the eager young clerk for his entrepreneurial spirit. Morris was only 22 when Thomas Willing, Charles' son, took him on as a partner.

The timing was perfect. Britain had just challenged France to a war of empire for the North American interior, and war meant opportunity. Morris enhanced his fortune by importing military stores, consumer goods, indentured servants and even slaves, while exporting commodities from American farms. He also engaged in privateering, government-sponsored piracy on French commercial vessels.

Morris had no political views to speak of, other than the simple belief that "commerce should be perfectly free, and property sacredly secure to the owner." But pre-revolutionary turmoil in the 1760s and early '70s interfered with free commerce. British officials placed constraints on trade, while American patriots responded by boycotting British goods. Although none of this was good news for Robert Morris, the war that followed



\$1,600 bill of exchange signed by Robert Morris, 1794.

was. Again, Morris profited by filling wartime needs, this time in an official capacity. As a delegate to the Continental Congress and chairman of the powerful Secret Committee of Commerce, he was charged with keeping the supply train flowing. Working tirelessly, Morris purchased goods for the Continental Army—often from the firm of Willing and Morris. Was that a conflict of interest? Certainly, but soldiers were fed, clothed and armed. Morris was more a procuring agent than an impartial referee.

Morris's peers, for the most part, were pleased. John Adams, fond of assessing the character and utility of delegates to Congress, wrote of Morris: "I think he has a masterly understanding, and open temper and an honest heart. He has vast designs in the mercantile way, and no doubt pursues mercantile ends, which are always gains; but he is an excellent member of our body."

George Washington's admiration for Morris went far beyond that, for without Morris's direct assistance on several occasions Washington would have had no Army. On the last day of 1776, with the terms of enlistment for his troops about to expire the next day, a desperate commander-in-chief jotted an urgent note to Morris:

Tomorrow the Continental troops are all at liberty. If it be possible, sir, to give us assistance, do it—borrow money where it can be done—every man of interest and every lover of his country must strain his credit upon such an occasion.

To which Morris responded the next day:

I am up very early this morning to dispatch a supply of \$50,000 to your Excellency. You will receive that sum with this letter but it will not be got so early as I could wish for none concerned in this movement except myself are up. I shall rouse them immediately. If further occasional supplies of money are necessary you may depend on my exertions either in a publick [sic] or private capacity.

By the end of 1776, Congress was relying on Morris shamelessly. He served not only on the Secret Committee of Commerce, but also on the Committee of Secret Correspondence, which communicated (sometimes using invisible ink) with foreign merchants and diplomats, and the Marine Committee, charged with creating an American Navy and distributing the goods

obtained by American privateers. When some delegates wondered why they were not better informed about certain business of the Secret Committee of Correspondence, the Committee, in the persons of Benjamin Franklin and Robert Morris, replied: "We are of opinion that it is unnecessary to inform Congress of this intelligence at present because Mr. Morris belongs to all the committees that can properly be employed in receiving and importing the expected supplies."

For better or worse, Robert Morris managed to make himself indispensable. When Congress fled Philadelphia on December 12, 1776 to escape the reach of an advancing British army, it left Morris behind to procure supplies and finance the army. He packed a wagon train loaded with his valuable possessions, ready to depart at a moment's notice should the need arise, and then conducted the various affairs of the nation by himself. He ordered salt sent to the countryside, purchased clothes for soldiers, rigged boats with guns, commandeered wagons to evacuate the city—all the sundry, on-the-ground decisions that had to be made in a time of crisis. While delegates at Baltimore did no more than talk, Morris acted. On one day alone, 23 of his letters were read on

the floor of Congress to the refugee delegates, who formally approved the “care of the public business as signified in Mr. Morris’s letters.”

Morris profited personally, even while serving the public good. “It seems to me the present opportunity of improving our fortunes ought not to be lost especially as the very means of doing it will contribute to the service of our Country at the same time,” he wrote to his agent in France. In addition to the no-bid contracts he issued to himself, he dispatched numerous privateering vessels, many of which returned with lucrative prizes. He also engaged in what we would now call a kickback scheme. He and Benjamin Harrison, a business associate and paymaster for the Army in Virginia, entered a pact that played to their mutual advantage: Harrison would send business Morris’s way, charging the Virginia government an extra 2%, while Morris would let out Congressional contracts to Harrison, also at a 2% premium. Morris did not seem to find anything improper about this arrangement.

Even so, Morris hankered to get back into the private sector, where he could shop the “good bargains” in “inland speculation,” which promised huge profits. He also hoped to take advantage of wartime shortages by accumulating scarce commodities and jacking up prices. “What think you,” he wrote to a business associate, “of buying up in your state all such prize goods (not perishable) as sell cheap and laying by awhile?”

After leaving Congress in 1778, however, this practice landed Morris in trouble. Ordinary citizens in Philadelphia did not appreciate the “forestallers,” “engrossers,” and “monopolizers” who profited at their expense, and on October 4, 1779, distressed by a 50% rise in food prices over the previous 10 days, a large crowd assaulted Morris, whom they deemed responsible, and some of his gentlemen supporters. Morris and company retreated to the three-story brick home of his

lawyer, James Wilson, and proceeded to fire on the crowd, killing five men. In the days following the “Battle of Fort Wilson,” as it was called, Morris was forced to hide inside his town house, too scared to light a candle at night.

By 1781, when Robert Morris assumed command of the government and the economy, more people resented the man than liked him, but that did not stop Congress from groveling at his feet. Things were that bad. Congress had lost all its credit: suppliers refused to advance it any goods or accept its currency as payment. Morris’s credit, on the other hand, was perfectly sound, so Congress created a special office—“Superintendent of Finance”—and asked him point-blank to take charge of the government’s affairs. He agreed, but only if he were allowed to run the show on his own. Congress had little choice but to agree. One prominent politico from Pennsylvania commented wryly:

The business of that august body has been extremely simplified, Mr. Morris having relieved them from all business of deliberation or executive difficulty with which money is in any respect connected, and they are now very much at leisure to read dispatches, return thanks, pay and receive compliments, etc. For form’s sake some things go thither to receive a sanction, but it is the general opinion that it is form only.

“*The Financier*.” Those two words, definite article and noun, uttered together, invariably inspired awe, whether from admiration or fear.

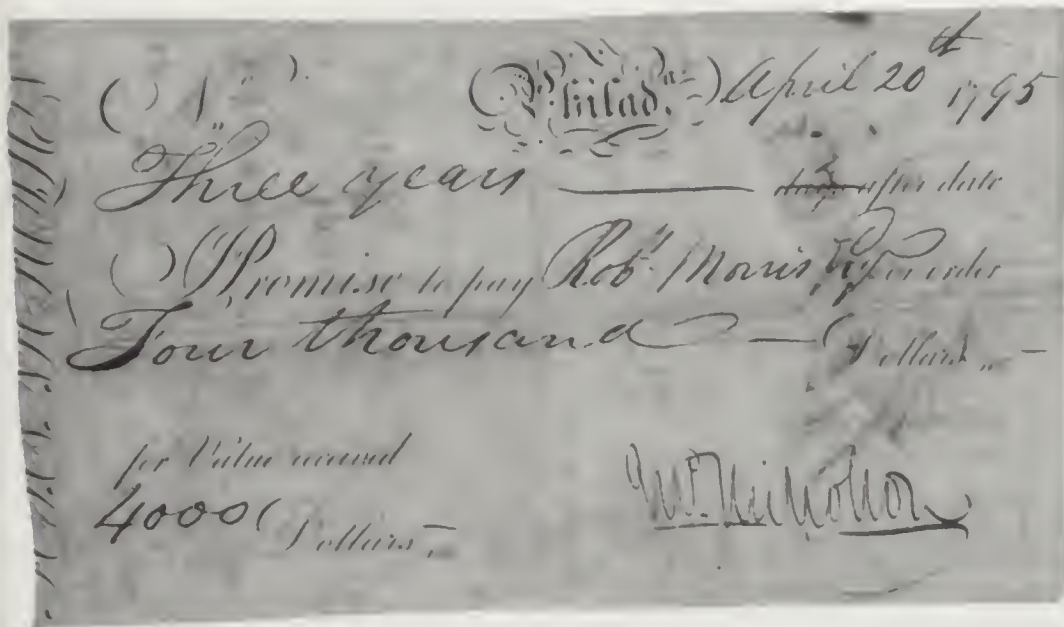
The lynchpin of Morris’s plan for recovery was a national bank, capitalized by private investors, which would extend credit to the government. In this manner, wealthy men would assume public debt, and once they did, they would make sure the government did not fail. The bank would operate without any restraints. There would be no limitations on the

type of investments, no restrictions or regulations, no time limit for the charter. To keep operations secret from “national enemies,” the books would be closed. One person alone would provide oversight: “the officer who is appointed to manage the monied interests of America,” that is to say, Robert Morris. Although the very notion of such an institution flew in the face of prevailing republican ideology, it took a mere nine days for Congress to approve the Bank of North America—even less time than it took Henry Paulson to garner Congressional approval for the \$700 billion bailout in the fall of 2008.

While the national bank helped the flow of credit, its notes were too large and issued too infrequently to function as the nation’s only currency. That’s why *The Financier* created “Morris Notes,” drafts of \$20 to \$100, redeemable in specie, signed by himself and watermarked “United States.” Morris’s own signature was key, for he vowed if the government could not make good on the notes, he would: “My personal credit, which thank Heaven I have preserved throughout all the tempests of the War, has been substituted for that which the country had lost.”

Starting in November of 1781, “Morris Notes” superseded Continental currency in common business transactions. The bad news was that people placed more trust in the financial viability of a single individual than they did in the solvency of their government; the good news was that this particular individual, who had profited greatly from the war, was willing to stake his fortune on behalf of a bankrupt nation.

By mutual consent, Robert Morris and Congress terminated their relationship on November 1, 1784. Morris, with his bank and his notes, had averted the crisis, but he never garnered the one power needed to place the United States on a firm financial footing: national taxation. That would come a few years later, with the new Constitution.



Museum of American Finance

\$4,000 promissory note to Robert Morris signed by John Nicholson, April 20, 1795.

"The pursuit of riches," Thomas Willing once jotted in his diary, is "the proper object of a reasonable man"—and once freed of public burdens, Morris was free to act reasonably once again. He monopolized tobacco exports to France, thereby driving down the price of tobacco here in America and angering southern planters, to whom he owed no more allegiance. With ships he had once used for privateering, he opened American trade with China and India. He invested freely and often, and he usually came out ahead.

In 1789, President George Washington offered his good friend and patron the post of Secretary of the Treasury under the new Constitution. This time Morris declined, for others could now handle the job. He preferred to pursue riches the unfettered way.

Like other capitalists in the New Republic, Morris saw the greatest opportunity in western land speculations. In 1795, relying on credit, his immodestly-named North American Land Company purchased 6,000,000 acres in seven states: New York, Pennsylvania, Virginia, Kentucky, North Carolina, South Carolina and Georgia. The venture promised to return

"at least four, but I believe 10 times" the original capital, he told potential investors. It was a speculator's millennial vision, profits beyond imagination. But as Morris searched for takers both in America and abroad, he found there were too many schemes such as his, and they could not all be capitalized. He failed to attract sufficient funds to pay back his original loans, and for the first time in his life, Robert Morris found himself unable to meet his outstanding obligations.

By the fall of 1797, the former financier was "besieged with creditors," not just figuratively, but literally. Secluding himself within his country estate, he braced for their charge. Some tried to enter by subterfuge. Others gathered and made a fuss at the gate. Finally, on February 14, 1798, an angry creditor convinced a local sheriff to enter the house, seize Morris, and escort him to the Walnut Street Gaol.

For more than three years Robert Morris languished in jail, confined (except for privileges of the yard) to a room with doubled-grated bars across the windows. Years earlier, when the nation was bankrupt, he had stepped forward to bail it out; now, nobody reciprocated. Friends like George

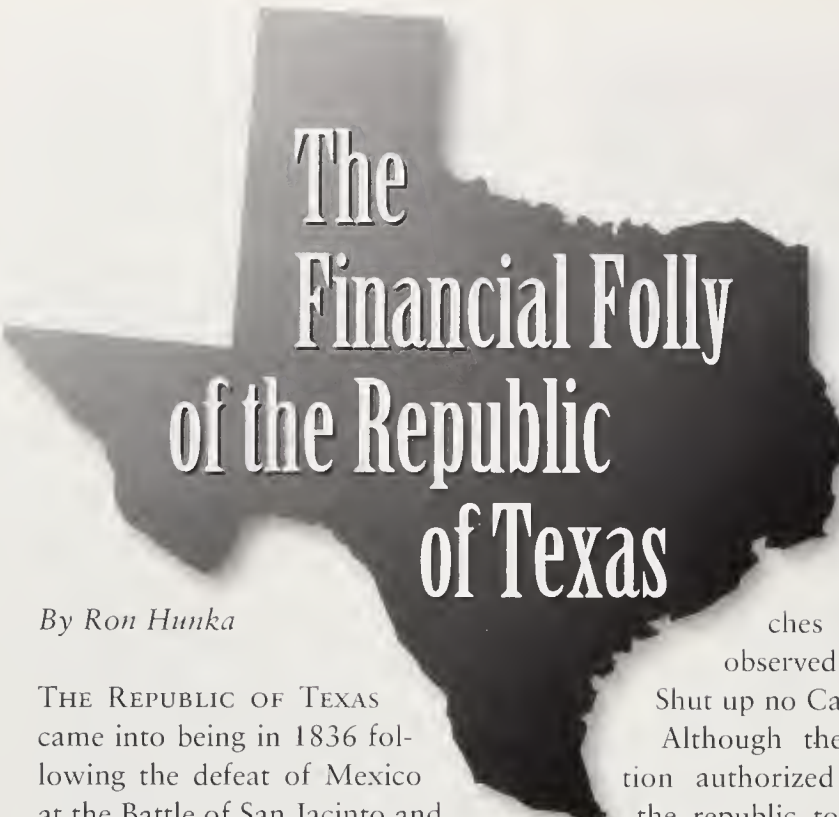
Washington might have helped if they could, but his debts were just too vast: \$2,948,711.11, by final tally. *The Financier* had fallen from the richest man in America to the poorest.

So ended Robert Morris's chance for inclusion in the national pantheon of founders. His life story, with its wretched ending, was not to be celebrated, no matter what he had done before. Riches to rags is not the American way.

In his stead we have Alexander Hamilton, Washington's second choice for Secretary of the Treasury. Think "finances" and "founder" in the same synaptic moment, and Hamilton's name automatically appears. But throughout most of the Revolutionary Era, Hamilton was considered a prodigy, not a powerhouse. It was only after Morris's reign that Hamilton gained such renown by implementing the nationalist policies first pushed by Morris.

Ironically, Robert Morris's final and inadvertent contribution to public affairs ran directly counter to the thrust of his life's work. Before Morris went to jail, the federal government, although empowered to pass legislation regulating bankruptcy, had done nothing about it. To men in power, the term "debtor" connoted poor farmers—but if *The Financier* could be imprisoned, who among them was really safe? In 1800, Federalist Congressmen pushed through a bill that allowed a debtor to be set free, pending the approval of two-thirds of his creditors, and under that law Robert Morris, age 67 and spent, was finally released. **FH**

Ray Raphael's most recent book, *Founders: The People Who Brought You a Nation*, features Robert Morris as one of seven lead characters. His 13 previous books include the bestselling *A People's History of the American Revolution*; *The First American Revolution: Before Lexington and Concord*; and *Founding Myths: Stories that Hide Our Patriotic Past*.



The Financial Folly of the Republic of Texas

By Ron Hunka

THE REPUBLIC OF TEXAS came into being in 1836 following the defeat of Mexico at the Battle of San Jacinto and the subsequent Treaty of Velasco, and ended in 1845 when Texas was annexed by the United States. In the first year of the republic, an agent of the U.S. government estimated that its population consisted of 30,000 Anglo-Americans, 3,748 Tejanos, 14,200 Indians and 5,000 slaves. During the brief life of the sparsely-settled, land-rich republic, it faced consistent currency predicaments. Yet, due to a general distrust of all banking operations, it did not charter a single government or private bank in its entire existence.

On the whole, financial conditions in the Lone Star Republic were closely linked to those of the United States. Regrettably, as one historian put it, Texas “had the misfortune to be born” just prior to the Panic of 1837 when 343 out of 850 banks in the United States closed permanently. During the Panic, economic conditions were comparable to those of the Great Depression. Roughly paralleling the life of the Republic of Texas, the Panic lasted until 1843. A Texas businessman summed up the influence of the U.S. economy on Texas as follows, “the wretched condition of everything of a monetary nature in the U.S.

renders all business doubtful and unpleasant.” In a diary entry in 1842, another individual in Nacogdoches more mundanely observed, “Grog Shops all Shut up no Cash.”

Although the Texas constitution authorized the congress of the republic to coin money and stipulated that only gold and silver coins would constitute legal tender, what gold and silver Texas had was soon sacrificed to a large trade deficit. With no currency of its own, confusingly, bank notes from banks in Alabama, Georgia, Louisiana, Mississippi, Tennessee, South Carolina, Indiana and New York were accepted at various discount rates throughout the republic. From 1836, when U.S. President Andrew Jackson killed the Second Bank of the United States, to 1863 when the Lincoln Administration printed “Greenbacks” to finance the Civil War, no federal U.S. paper money was issued. All notes in circulation were issued by individual banks.

Adding to the pecuniary chaos, defunct, valueless currency also circulated, such as those from banks in West Florida, Holly Springs, Pontitock and Chickasaw. To make a bad situation worse, counterfeit notes were stirred into the mix. One merchant complained that with so many different bills in circulation that “one does not know what is good and the only safety is to pass it on as you get it.”

In such a currency free-for-all, the barter system naturally found appeal. Accordingly, animal pelts, cows and

calves were regarded as practical media of exchange—a cow and a calf having a currency equivalency of \$10. As the cash problems persisted, even payments for exports from and loans to the republic had to be converted into goods of some type.

Sam Houston's Star Money

On June 12, 1837, contrary to the Constitution and in order to avoid what President Sam Houston called “the absolute dissolution of the government,” Congress authorized the issue of \$500,000 in promissory notes, paper currency. These notes were called “star money” due to the prominence on one face of a large five-pointed star, such as is depicted on the Texas state flag today. The non-reissuable notes offered 10% interest, payable in 12 months, and they were backed by one fourth of the proceeds from the sale of public land on Galveston and Matagorda islands, as well as confiscated Mexican land and property. Characterizing the efficacy of star money, Ashbel Smith, one-time secretary of state of the Republic of Texas wrote reflectively in 1879, “In short business transactions, it passed at par with the best bank notes of the United States.”

The 1837 star money worked well enough that in May 1838, congress misguidedly planned the reissuance of the originally non-reissuable notes, as well as one million more such notes. A fiscal conservative, President Houston vetoed the bill. However, the congress, modeled on its U.S. counterpart, overrode his veto.

Houston had viewed the original promissory notes as a temporary measure until taxes and other government revenues could be deposited



Front of a \$3 Republic of Texas redback first issued in the administration of Mirabeau Lamar in 1838.

Courtesy of the Texas Library and Archives Commission

in the treasury. But the conservative approach of the executive branch was ignored by the legislative branch. Ashbel Smith recalled the measure as, "The first step downwards of the Republic of Texas in the career of financial folly." By January 1839, the new promissory notes, unlike their predecessors had depreciated in specie value to 40 cents on the dollar.

Even during these difficult times, there was a good deal of land speculation going on across the vast, largely vacant republic where landholders laid out numerous new towns with wistful names, such as Montezuma, Columbia, Oregon, Powhatan, Monadelphina and Manhattan. However, by early 1840, few purchasers had been found for the properties in them, due to the shortage of cash. In December 1840, the *Houston Telegraph and Texas Register* reported that eight counties had been unable to pay any taxes whatsoever to the treasury of the republic the previous year. Over the next few years, newspapers were full of accounts of foreclosures and auctions, including the former properties of prominent persons who were unable to pay their taxes.

Mirabeau Lamar's Vision of Empire and the Redback System

Under the Texas constitution, the president could not succeed himself. When Houston left office in 1838, his vice president, Mirabeau Lamar, who was elected by 6,995 votes to 252 for Senator Robert Wilson, succeeded him. Though vice president under Houston, Lamar was largely not in agreement with the policies of his administration, and this view was particularly true of his monetary policy. In this outlook, Lamar had the strong support of the senate, one third of whom were recently elected and the house, all of whom were newly elected. Ashbel Smith wrote of Lamar that a man of "stricter pecuniary integrity I have never known; finance however was not his forte."

Though many in the republic, including Sam Houston, compellingly argued for the annexation of Texas by the United States, Lamar thought otherwise. Espousing his own brand of Manifest Destiny, he viewed Texas as an unrealized empire that would eventually expand westward to the Pacific Ocean. At the time of his inauguration, nonetheless, the repub-

lic had garnered diplomatic recognition from only one nation, the United States. Lamar's ambitions came at a high price that ultimately led Texas to financial insolvency.

In an address to congress on December 21, 1838, Lamar had expressed a desire for the establishment of a national bank owned and operated by the government. However, congress did not support him in this regard. Instead, it authorized the issuance of new, non-interest bearing promissory notes that came to be known as "redbacks" from the hue of their ink on the reverse side. Redbacks were fiat money, issued on the faith and credit of the republic and nothing more. Unlike star money, no maximum limit was placed on the amount of redbacks that could be issued, other than that of legislative appropriation.

In 1839, there was still a significant Indian presence in Texas. Sam Houston, who at the age of 16 in Tennessee had run away to live among the Cherokee where he acquired the name "the Raven," had pursued a policy of rapprochement with the Indian tribes in Texas during his presidency. On the other hand, Lamar saw the Indians as

an impediment to “civilization” and pursued a policy of expulsion, if not extermination.

That same year, Lamar, claiming that the Cherokees were intriguing with Mexico against Texas, dispatched military forces against them in north east Texas, killing many and driving the rest into Arkansas. In 1840, he sent Texas Ranger companies in a great campaign to kill or force out the Comanches, who hunted buffalo over a vast area in Kansas, New Mexico, Colorado, Oklahoma and Texas, known as “Comancheria.” However, this extremely expensive effort had such little long-term effect that 30 years later, for example, the population of Wise County in north central Texas had decreased from 3,160 to 1,450 over the previous 10 years, due to the terror inspired by raiding of the Comanches.

Despite Texas’s victory over Mexico at San Jacinto in 1836 and the terms of the Treaty of Velasco, Mexico still did not recognize Texas as an independent nation. Accordingly, one of Lamar’s campaign promises in 1838 had been to militarily engage Mexico until it gave diplomatic recognition. For this purpose, Lamar argued, Texas needed a navy, and six ships were therefore procured at an expense in excess of \$500,000.

In June 1841, congressional approval failing, Lamar took it upon himself to authorize an expedition to Santa Fe in an attempt to gain control of the northern land granted to Texas in a secret provision of the Treaty of Velasco. As a result of the stipulation of the Rio Grande as the border between Texas and Mexico, the republic theoretically included half of what is now New Mexico and part of Colorado, where the river rises.

By acquiring the significant trade revenue from the Santa Fe Trail, Lamar hoped to provide a source of much needed income for Texas. However, necessary supplies and merchandise to outfit the approximately 300 men and 21 wagon expedition cost



\$5 Republic of Texas note.

about \$200,000. In the end, the effort resulted in the surrender of the Texas forces—defeated more by the hot, dry conditions of west Texas and eastern New Mexico than the Mexican army—with the survivors marched off to prison in Mexico.

Given the large issuance of redbacks to cover the expenses of Lamar’s programs during the three years of his administration, their value sunk disastrously—ultimately to as little as three to four cents on the dollar. When Lamar had taken office, the public debt stood at \$800,000. By the end of his term, it had risen to \$2.5 million. The Republic of Texas now found itself in desperate circumstances. There was nothing in its treasury, and the nation had no viable currency for business transactions.

The Return of the Raven

Lamar’s presidential term expired in December 1841, and Sam Houston, again eligible for the office, was elected president for the second time in a period of financial crisis for the foundering republic. Houston, having been forced to manage his business affairs the previous summer completely without the benefit of cash, was acquainted with the currency viability issue first-hand. In response to the redback crisis, as president, he moved to discontinue the acceptance

of the currency in the administration of Texas government.

On January 19, 1842, Houston gained legislative approval to issue exchequer notes whose redemption was based on the taxes of the customs houses that could only be paid in gold. A ceiling of \$200,000 was set on the issue of exchequer bills although the total amount issued during the period reached only \$150,490. Initially, the bills decreased in value to the extent that by summer 1842, they were worth only 25 cents on the dollar. As in the earlier days of the republic, Texans again familiarized themselves with the nuances of a barter economy.

A British visitor to the town of Columbus in 1843 noted the following exchange equations in the ledger of a local merchant, “Cotton for sugar and Coffee—Bacon for boots—Corn for Calomel [a laxative] and quinine & Whiskey—Beef for Brandy.” A German traveler also wrote, “A Texan is ready at any moment, even when traveling, to trade or sell anything he wears, whether it is his coat or shirt.” Doctors accepted produce for medical services, as did editors for newspaper subscriptions. Boarders often paid for meals with cows, and a carpenter might perform services for a gun. For a time, wealth ceased to be appraised in dollars, and, instead, it came to be expressed in slave holdings.”



Reverse side of a \$5 redback (printed completely in red ink). This face of each redback was identical with every other as there were no denominational markings on it.

Annexation and Aftermath

Eventually, the strength of the growing annexation movement in Texas along with Houston's frugal administration of government increased the value of the exchequer bills through 1843 and 1844.

After the end of Houston's second term, on December 9, 1844, Anson Jones, the last president of the Republic of Texas, was sworn in and continued Houston's conservative financial policies and drive toward annexation. By 1845, the exchequer bills' value reached par in some parts of the republic, and there was, at last, gold in the treasury. Houston and others of the same outlook had found vindication for their view that Texas' well-being was inextricably linked to that of the United States.

On December 29, 1845, during the administration of U.S. President James Knox Polk, an advocate of Manifest Destiny, Congress passed a *Joint Resolution to Admit Texas as a State*. Less than four months later, an attack by a Mexican cavalry unit on an American patrol north of the Rio Grande near Brownsville served as the nominal reason for a declaration of war by the United States against Mexico.

A Post Script to Currency and Viability Issues of the Republic

Less than 20 years after annexation, by the fall of 1864, Texans' acquaint-

ance with near-worthless currency and barter was again renewed when Confederate money dropped in value to 2.5 cents to the dollar. Some foresighted legislators, who came to Austin to debate finance and the status of the war in the congressional session, brought with them tobacco and nails as barter commodities. Others less prescient had to camp in their wagons on the grounds of the state capitol when Austin innkeepers and merchants refused to accept their Confederate money.

After the legislature voted to end the acceptance of Confederate currency in Texas, it gave some consideration to a return to the republic. But sufficient support for that previously-tried form of government could not be found.

More recently on April 15, 2009, Texas Governor Rick Perry spoke to a tax protester "Tea Party" on the shores of Lady Bird Lake in Austin. In answering reporters' questions afterward, Perry briefly resurrected the notion of a return to the republic when he "suggested Texans might at some point get so fed up they would want to secede from the union." **EH**

Ron Hunka lives in Austin, Texas, and writes freelance historical magazine articles. Previously, he has contributed pieces to Financial History on the frauds of infamous Texans Billie Sol Estes and Frank Sharp. Recently,

in History Magazine, he wrote about the economic effects of the Confederate circumvention of the Union blockade in the Civil War via a Mexican port near Brownsville, Texas, and the financial issues of colonial Spain associated with the wreck of a flota of treasure ships on Padre Island in South Texas in 1554.

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The Match King: Ivar Kreuger, The Financial Genius Behind a Century of Wall Street Scandals



By Frank Partnoy, *Public Affairs*, 2009, 272 pages, \$26.95

Reviewed by J.P. Prout

A legendary financier's aura of invincibility suddenly evaporates to reveal tangled webs of fraud, deceit and dishonesty. How could it have happened, we ask? How could so many smart and sophisticated people have been duped for so long? Unfortunately, these questions aren't vintage 2009; they were asked roughly 75 years ago after the spectacular fall of Ivar Kreuger, the principal player in one of the most dramatic 20th century financial scandals. Along with the loss of millions, the ruination of a venerable U.S. banking firm, and a suicide, Kreuger's legacy includes the system of U.S. market regulation which Congress is just now beginning to overhaul.

Kreuger's story is well known to most readers of financial lore. It was chronicled in detail after his fall with official

hearings, several books and articles, and even a movie. Investment banker turned law professor and author Frank Partnoy's version does not try to radically change our thinking on Kreuger. Rather, his book is a sturdy, readable and thoroughly-researched updating that cleans up existing source materials, while adding new data on Kreuger's day-to-day businesses activities.

Partnoy opens the Kreuger saga in 1922, as the 42-year-old Swede travels to New York. By any standard, he is a success. A gifted businessman, he is already a millionaire, heading the well-known and respected construction concern, Kreuger & Toll. Looking further afield, he expanded his interests into newer, faster-growing sectors. One was moving pictures and another was producing a simple, everyday consumer product: the safety match.

Unlike now, striking a match in the 1920s occurred many times a day. And by then, technology had made them safer and portable. By vigorous consolidation and astute financial and production management, Kreuger's Swedish Match company had established monopoly status in its home market. For Kreuger, this was the key to solving the core dilemma with producing and selling matches—thin margins. As he surveyed opportunities in Europe and elsewhere, he realized he could build or buy national match monopolies by offering attractive terms to cash starved governments. The challenge was getting enough capital, and that meant going to the cash rich U.S.

Kreuger had picked a perfect time to make his pitch to U.S. investors. As the '20s progressed, the consumer market had taken off and with it the stock market. There was growing competition

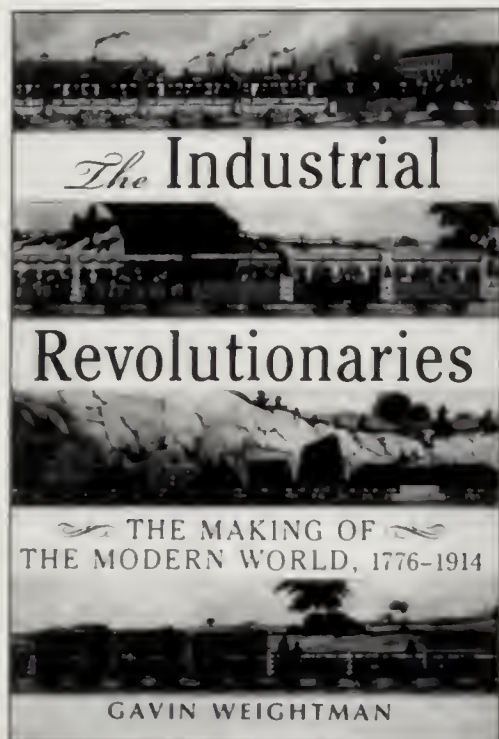
among banks to float new issues, and Boston-based Lee Higginson & Co. was happy to help Kreuger gain traction with European governments who had traditionally tapped J.P. Morgan for funding needs. A big plus was the lack of timely or comprehensive financial controls or reporting. As the decade progressed, Kreuger raised hundreds of millions of dollars through successive stock offerings that were energetically snapped up.

In the 1930s, his financial model started to unravel. He had made commitments he could not meet. While he had always skated close to edge, by early 1932 Kreuger's attempts to stave off inquiry and exposure became frantic. His shocking end, alone in a Paris apartment as investors waited around the corner, was a dramatic ending to a storied career.

The book is well paced and edited, with Partnoy's deliberate style belying his legal background. Occasionally, he goes too far trying to illuminate Kreuger's "dark side" by highlighting the importance he placed on his image and aura. Most promoters, as Kreuger certainly was, spend a lot of time on these issues—it is a fundamental part of the process of building credibility and raising money.

Kreuger's saga provokes lively debate to this day, with a sizeable group of people still arguing his case. His business empire was real, with considerable holdings that took years to unwind, and the final payback to investors was not inconsiderable. Kreuger was not your run-of-the-mill cheat. Unfortunately his skills at covering up and dissembling to gullible investors and intermediaries look all too familiar to those taken in by more recent "investment geniuses." **FH**

The Industrial Revolutionaries: The Making of the Modern World, 1776–1914



By Gavin Weightman
Grove Press, 2009
432 pages with notes, index
and illustrations,
\$27.50

Reviewed by Michael A. Martorelli

Mention the Industrial Revolution to the average American, and he/she probably will think of Carnegie, Edison and Rockefeller; the average reader of *Financial History* might also know of Bessemer, Stephenson and Watt. In *The Industrial Revolutionaries: The Making of the Modern World, 1776–1914*, British social historian Gavin Weightman skillfully tells the tale of these and other giants of innovation and discovery. Along the way, he provides the complete story behind the development of the steam engine, the telegraph and other products. Fre-

quently debunking the myth of the “eureka” moment so embraced by many popular histories, the author emphasizes the evolution of many familiar products and technologies by recounting the long-lasting and many-faceted attempts to commercialize products in the oil, iron/steel and automotive industries. In focusing much attention on such activities in Great Britain, he brings considerable value to the reader whose knowledge of the Industrial Revolution is limited to late-19th century Americans.

The author clearly views the events and developments that occurred from 1776 to 1914 as anything but pre-ordained. In focusing on the conscious activities of people (dozens of inventors, scientists, engineers and entrepreneurs are named throughout the book’s pages), Weightman gives more attention to the men who were the *revolutionaries* than to the sociological explanations of either the first or second industrial *revolutions*. He describes his protagonists’ efforts not as altruistic attempts to improve the lot of their fellow men, but as attempts to create useful products that would fill a need and generate some income. Frequently, it was not the initial inventor or discoverer of a new product or technology who most prospered from an invention, but the later entrepreneurs who figured out the way to optimize the utility of that product for the largest audience of businesses or consumers.

Many authors have discoursed at length on the rationale for the progression of industrialization at various times and in various places. Weightman does discuss how differences in social attitudes, industrial infrastruc-

tures and political systems affected the development of technologies in various European and Asian countries. However, those comments serve as bridges between accounts of invention across borders, not as principal elements of his narrative. In between the stories of his numerous subjects, he also weaves some detailed accounts of broader developments, such as the prevalence and importance of industrial espionage in 18th century England, the transposition of France and the United States as industrial powers in the mid-19th century, and Japan’s entry into the industrial world in the late 19th century. Using such a broad timeline as 1776–1914 enables this author to follow the path to industrialization that eventually enabled both Japan and Germany to become far more influential in world affairs than the size and history of their countries would have suggested.

In his zeal to record the most thorough account of various developments, Weightman sometimes strays from the main storyline and brings in other aspects of the times. On balance, however, the continuity of his narrative is clear, thanks to some useful transitional sentences at the end of each chapter. *The Industrial Revolutionaries* is not a sweeping arc of industrial progress in the 18th and 19th centuries, but it should be quite appealing to all who are fascinated with that remarkable period of inventiveness. **FH**

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For Us or For Them?

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least-monitored in the whole system. Regulators could not chastise them without fear of political reprisal and their bondholders, lulled to sleep by the government guarantees, had little incentive to pry. It was no accident that the GSEs invested heavily in subprime mortgages and other risky assets.

The complexity and mammoth size of many financial institutions today is also no accident, but rather the direct result of the confluence of specific market forces and governmental incentives. With the advent of Too Big to Fail (TBTF) policy in the mid-1980s, a free insurance scheme for the nation's biggest financial institutions, the government actually encouraged large size and complexity. Regulators believed, mistakenly as it turned out, that bigger was sounder. They learned from the Great Depression and the Savings and Loan Crisis that small banks are fragile. Unit banks (branchless banks) have a difficult time diversifying their loan portfolios sufficiently to withstand economic shocks and regulators must constrain small institutions from investing in asset classes, like securitizations and other derivatives, which their managers usually do not fully comprehend. It does not follow, however, that because small banks are risky, large banks are safe. Big bankers are imperfect beings too, and as discussed above often personally benefit from making large bets with what is essentially taxpayer money.

To reduce the chances of a recurrence and to mitigate the effects of any future panic, policymakers should undertake non-partisan reforms that directly address the hybrid nature of the failures that led to the crash. The government could start by eliminating tax incentives to invest in the stock market instead of in homes. It could also encourage companies to devise deferred compensation structures, especially in long-term financial

businesses like mortgages. Fannie and Freddie, already in conservatorship, should be wound down completely or re-nationalized so that socialized risks will also lead to socialized profits. Similarly, the government should charge the market price for guaranteeing the liabilities of companies that it deems are too big or complex to fail.

Of course even those reforms may prove insufficient to prevent all future crises. The government should therefore devote some resources to improving its crisis response. History can provide important guidance again here. Econometric evidence suggests that over recent decades, bailouts both at home and abroad have not sped economic recovery on average. In the more distant past, however, some bailouts succeeded admirably without unduly taxing innocent bystanders or encouraging further risk-taking (increasing moral hazard in the parlance of economists). The key appears to be the type of bailout implemented.

Table 2 lists major types of government bailouts. Those that socialize risk while allowing private entities to profit (e.g., 6a) are objectionable on economic as well as moral, re-distributional grounds. Such bailouts may re-capitalize battered financial firms, but they are equally likely to impose large costs on taxpayers with little in the way of corresponding benefit. The best types of bailouts are those, like Hamilton's Rule (6b), that socialize profits as well as risks. They are fairer for taxpayers and hence more politically palatable and also much less likely to foment future risk-taking and recurring crises.

First implemented by Treasury Secretary Alexander Hamilton in response to the Panic of 1792, Hamilton's Rule holds that the lender of last resort should lend freely but at a penalty rate to all who can post sufficient collateral. The rule allows the lender of last resort (the Bank of the United States then and the Fed today) to save safe companies facing temporary liquidity restraints but

chastens them with relatively high rates. It also allows risky companies to fail in droves. That sounds negative, but in fact is palliative because it quickly exorcises the financial system of its demons. The rule worked perfectly in 1792; the panic ended quickly and was not followed by recession. Perhaps more importantly, the U.S. financial system did not suffer another nationwide peacetime financial panic until 1819.

The same could not be said for the modern central banking rule (6a) used repeatedly by Federal Reserve Chairman Alan Greenspan. Each time that the Fed interceded, risk-taking market participants were rewarded because whenever trouble struck (e.g., the 1987 stock market crash, the failure of Long Term Capital Management, the dotcom bust), the Fed lowered interest rates and flooded banks with money. Unsurprisingly, the crises grew progressively larger until they almost ruined the global financial system and world economy in September 2008. The Fed again prevented a complete meltdown, but in the process it planted the seeds of future crisis. Whether those seeds will again grow to bear the bitter fruit of financial panic and economic despair depends largely on how reforms, including those currently under consideration in Congress, influence risk-takers' expectations of the size and nature of future bailouts. The more Hamiltonian those reforms are, the better off taxpayers and the economy will be. **FH**

Wright is the Nef Family Chair of Political Economy at Augustana College in Sioux Falls, South Dakota. He has been a member of Financial History's editorial board since 2008 and is one of the editors of the Museum of American Finance's Recessipedia.com wiki. He is also the author of Fubar-nomics (Prometheus, 2010) and the editor of Bailouts: Public Money, Private Profit (2009), a joint publication of Columbia University Press and the Social Science Research Council.

Wall Street and the Dust Bowl

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Notes

- 1 The dust bowl boundaries moved from year to year during the 1930s and sometimes included Amarillo which experienced severe wind erosion in 1935 and 1936. The heart of the dust bowl experienced severe wind erosion throughout most of the decade and centers on, according to environmental historian Donald Worster, Morton County in Kansas, Baca County in Colorado, Texas and Cimmaron Counties in Oklahoma, Dallam County in Texas, and Union County in New Mexico.
- 2 Those factors included technological developments (tractors, combines, and other implements) that allowed farmers to plow, plant, and harvest on very marginal land, a tendency to concentrate on wheat production, tenant farmers who were more likely to abandon land that failed to produce, and soils whose erosive properties were greatly enhanced if not cared for properly.
- 3 Peter Friesen of Newton, Kansas, who experienced the dust storms as a child in the Meade, Kansas area, told me (Brian Grinder) about a creative farmer who wired an electric light bulb in a barn that was sided with galvanized steel so that when the dust storms rolled through, the static electricity from the barn's siding would light up the bulb.
- 4 According to Guthrie, "Anyway, I remember the particular evening of April the fourteenth, 1935, that this dust storm here blowed up. I was standing, a whole bunch of us were standing just outside of this little town..., and so we watched the dust storm come up like the Red Sea closing in on the Israel children. Anyway, we stood there and watched the son of a gun coming up. And I'm telling you it got so black when that thing hit, we all run into the house, and all the neighbors congregated in the different houses around over the neighborhood. We sit there in a little old room, and it got so dark that you couldn't see your hand before your face, you couldn't see anybody in the room. You could turn on an electric light bulb, a good, strong electric light bulb in a little room and that electric light bulb hanging in the room looked just about like a cigarette burning. And that was all the light that you could get out of it. And so we got to talking to, you know, and a lot of the people in the crowd that was religious-minded and they was up pretty well on their scriptures, and they said 'Well, boys, girls, friends and relatives, this is the end. This is the end of the world.' And everybody just said, 'Well, so long, it's been good to know you.' I made up a little song there—kind of one of my own making. It's called 'So Long, It's Been Good to Know You.' "
- 5 Riney-Kehrberg has argued that tenant farming was actually a good way to manage risk in semiarid regions because tenants did not have to deal with the regularly occurring bills that pile up even in the dry years when one owns land, and because tenancy allowed them to invest more of their capital into farm machinery that could easily be moved about. Unfortunately, this also meant that they didn't have to commit resources to the maintenance of the land.

TRIVIA QUIZ

How much do you know about financial history?

By Bob Shabazian

1. When was the world's earliest share certificate issued?
2. What is Tax Freedom Day?
3. When was the U.S. income tax first enacted, and how long was it in effect?
4. Name the former Federal Reserve System chairman tapped by President Barack Obama to head up the Economic Recovery Advisory Board.
5. What was the tax rate when the income tax was enacted in 1913?
6. Approximately how much was Abraham Lincoln worth when elected president?
7. Who toured the New York Stock Exchange floor with President Ronald Reagan in 1992?
8. What law covers the amount of pensions for U.S. Presidents once they are out of office?
9. What do the now defunct U.S. Leather Co. and the Tennessee Coal, Iron and Railroad Co. have in common?
10. In the history of the Dow Jones Industrial Average, what was the largest single day percentage gain?

1. In 1606, by the Dutch East India Company.
2. The day the average American earns enough to pay his or her taxes. In 2009, the day was April 13.
3. In 1862, to pay Civil War expenses, and the tax was repealed 10 years later. Congress revived it in 1894, but the Supreme Court ruled it unconstitutional a year later.
4. Paul Volcker.
5. 1% on net personal income exceeding \$3,000, and 6% on incomes greater than \$500,000.
6. \$15,000 in savings, real estate and investments.
7. Soviet President Mikhail Gorbachev.
8. The 1958 Former Presidents Act.
9. They were members of the original Dow Jones Industrial Average.
10. On March 15, 1933, the Dow rose 15.34 percent (8.26 points to close at 62.10).

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